COMMITTEE ON WAYS AND MEANS

HEARINGS BEFORE THE

SUBCOMMITTEE ON TRADE
(Volume 1 of 5)

104th Congress
1995-1996

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COMMITTEE ON WAYS AND MEANS

WRITTEN COMMENTS BEFORE THE

SUBCOMMITTEE ON TRADE
(Volume 5 of 5)

104th Congress
1995-1996

ACCESSION OF CHILE TO THE NORTH AMERICAN FREE TRADE AGREEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JUNE 21, 1995

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ACCESSION OF CHILE TO THE NORTH AMERICAN FREE TRADE AGREEMENT

WEDNESDAY, JUNE 21, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:07 a.m., in room 1100, Longworth House Office Building, Hon. Philip M. Crane (chairman of the subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
June 7, 1995
No. TR-10

CONTACT: (202) 225-1721

Crane Announces Hearing on Accession of Chile to the North American Free Trade Agreement

Congressman Philip M. Crane (R-IL), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the proposed accession of Chile to the North American Free Trade Agreement (NAFTA). **The hearing will take place on Wednesday, June 21, 1995, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony will be heard from both invited and public witnesses, including U.S. Trade Representative Michael Kantor.

BACKGROUND:

The NAFTA implementing bill was enacted on December 8, 1993, and took effect on January 1, 1994. Article 2204 of the Agreement governs the accession of new members to the Agreement. Chile was first recognized by President Bush as qualified to be a future member of NAFTA when he announced the Enterprise of the Americas Initiative in 1990. The hemispheric agreement to complete the Free Trade Agreement of the Americas by 2005 was signed at the Summit of the Americas on December 11, 1994. Following this meeting President Clinton, Canadian Prime Minister Chretien and Mexican President Zedillo announced their intention to negotiate NAFTA accession with Chile. These talks will formally begin on June 7, 1995, in Toronto.

In announcing the hearing Crane said: "The NAFTA agreement represents an historic pact by NAFTA members to ensure the growth and economic health of their countries and the region through free trade, open markets and diminished government regulation. Because Chile's performance exemplifies these ideals, it has earned the opportunity to negotiate membership in the most comprehensive trade agreement ever established. Chile's expeditious accession to NAFTA is a top trade and foreign policy priority, and I urge the Administration to accelerate its efforts to achieve our common goal."

FOCUS OF THE HEARING:

The focus of the hearing will be to examine whether the proposed accession of Chile to the NAFTA agreement is in the national economic interest of the United States. Testimony will be received on specific objectives for the negotiations with Chile, as well as on the anticipated impact of an expanded NAFTA agreement on U.S. workers, industries and other affected parties.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Wednesday, June 14, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Trade will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-6649.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. The full written statement of each witness will be included in the printed record.

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. Testimony should arrive at the Subcommittee on Trade office, room 1104 Longworth House Office Building, no later than 1:00 p.m., Monday, June 19, 1995. Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Thursday, July 13, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Trade office, room 1104 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

*****

Chairman CRANE. The subcommittee will come to order.

Let me ask first, are Congressman DeFazio, Congressman Woolsey, or Congressman Riggs here yet?

Let me announce today's schedule. We are going to hold these hearings until noon. We are going to break at noon because there is a conflict. We will reconvene at 2 o'clock. But according to the cloakroom, they anticipate probably getting an amendment vote, the final amendment vote on military construction at about 11 o'clock, and then there may be a motion to recommit, and then final passage. So I simply want to alert our witnesses.

I think the panel starting with Malcolm Wilkey, Sid Weiss, John Sweeney, and Robert Housman, if they are in the audience, it is safe to say there is little possibility of us being able to get to you folks until at least 2 o'clock.

So, with that, I want to welcome the witnesses here today to discuss the extraordinary success of Chile and the opportunity that Chile's accession to the NAFTA, North American Free Trade Agreement, represents for the United States.

Chile's economic performance exemplifies the ideal of achieving growth through free trade, open markets, and diminished government regulation. Having sought a free trade agreement with the United States prior to Mexico, Chile is now more than ready to join NAFTA.

Chile's patience with U.S. intramural politics is to be commended, but we have to question how long we can expect Chile to wait for the United States to follow through on its commitment. The stakes are high for U.S. credibility and leadership in the Western Hemisphere. I am personally committed to the objective of achieving a free trade agreement in the Americas by 2005, as agreed to by countries at the Miami summit.

Achieving Chile's accession to NAFTA is the first step on a long important road the United States must take to ensure a vibrant economy in the 21st century. If we falter here, our future will be less secure. Over time, as other markets in the region continue on their dynamic growth path, our ability to bring them into a NAFTA-type framework will be diminished. We must succeed in implementing Chile's accession to NAFTA expeditiously, and I look forward to today's testimony to support this compelling goal.

I would like to yield to our distinguished ranking minority member, Charlie Rangel, for any opening comments.

Mr. RANGEL. Mr. Chairman, I would ask unanimous consent that my prepared written statement be entered in the record.

Chairman CRANE. Without objection, so ordered.

Mr. RANGEL. I would just thank you for the speed in which you have placed this matter on our calendar. Most of us know that the United States is very anxious to have the whole world know that we are the leaders in free trade and that, in doing so, we are really changing the direction of our economy, meaning that we will be moving toward a service economy, rather than the low-skill jobs that have prevailed in the past.

It is very important, whether we are talking about GATT, NAFTA, or expanding NAFTA, that we consider making investments in our educational system so that no Americans are left behind. I say that because, as we talk, many Americans are left be-

hind because of the loss of low-skill jobs, so it means that we are going to have to pay particular attention to make certain that all Americans are beneficiaries.

Having said that, with our young people without education, without jobs, and without hope, there is a tendency for this group of people to find itself more susceptible to drug addiction, alcohol abuse, crime and violence, and it ends up costing society much more, not only in lost productivity, but in hundreds of billions of dollars in terms of crime prevention.

It would seem to me that our South American friends and neighbors should not be so sensitive when we put the issue of narcotics on the table. Mexico resented it, other countries resent it, and what makes it hard for me to understand, even our country resents placing the issue of illegal narcotics trade on the table.

So I am supporting this vehicle because it means free trade. I hope we understand that Chile has a lot of problems internally as relates to threats to democracy by military people. But we think that trade is the way to handle it, rather than the ridiculous way in which we are trying to gain democracy for the people in Cuba. Trade is the vehicle to be used. We use it in North Korea, we use it in North Vietnam, we use it in China, and if we have problems with other countries, it should not be at the expense of free trade.

I thank you for your patience.

[The prepared statement follows:]

OPENING STATEMENT OF HON. CHARLES B. RANGEL

Mr. Chairman, I welcome this hearing on the possible accession of Chile to the North American Free Trade Agreement. Since these negotiations have been launched recently, it is very important and timely for the subcommittee to understand the issues involved and the implications for U.S. industries and workers.

I am particularly interested in the views of the administration and our other witnesses on how labor and environmental issues should be dealt with in this negotiation. Moreover, as I have noted in our earlier hearings on renewal of fast track, I personally believe that foreign cooperation in our efforts to stop illegal narcotics trade is also an appropriate issue to raise in the trade negotiation context.

Mr. Chairman, I look forward to today's testimony and to working with you and the subcommittee on these negotiations.

Chairman CRANE. Thank you, Mr. Rangel.

Our first witness is Congressman DeFazio.

STATEMENT OF HON. PETER A. DeFAZIO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OREGON

Mr. DEFAZIO. Thank you, Mr. Chairman.

I would ask that my full statement be entered in the record.

Chairman CRANE. It will. Let me preface your statement by saying that if you confine your oral presentations to 5 minutes, anything beyond that will be included in the record.

Mr. DEFAZIO. Mr. Chairman, I will depart from the prepared statement in my remarks and try and keep them brief.

I have some difference with the subcommittee here on the issue of the wisdom of admitting Chile at this time into the North American Free Trade Agreement. My concerns result from the experience of NAFTA.

If one were to go back and review the hearing record from 3 years ago and prognostications by all the financial pundits and economic experts with the administration regarding NAFTA and com-

pare it to the actual experience with NAFTA, one would find that none of those rosy predictions have been borne out. In fact, as of this point in this year, we have run a $5.3 billion trade deficit with Mexico in the first 4 months of the year.

Mexico is projecting, in order to satisfy its current accounts problems, that they will run $20 billion trade surpluses with the United States into the indefinite future. This certainly defies the predictions of the pundits and the supporters of NAFTA that somehow this would be a boon to the United States, it would help us with our trade deficit, and that it will produce jobs in this country.

The Commerce Department has certified through the Labor Department that over 17,000 people have received assistance because it has proven that their jobs have been exported to Mexico, and the estimates, of course, are much higher, if one uses the net trade figure. The Commerce Department is happy to tell everyone that every $1 billion of trade creates 20,000 jobs, but they do not want to talk about net. If we apply their same measure, the net to Mexico, we would be over 100,000 jobs lost in the first 4 months of this year, headed perhaps toward 400,000 for the year.

Now we are embracing Chile. I do not know if the subcommittee is following current events, but Chile is having a rather dramatic standoff between the civilian elected government and the military fascists, the Pinochet folks, who have spirited off a general who committed crimes against humanity, has been convicted, and is hiding him on a military base and refusing to turn him over to civilian authorities.

I question the wisdom of entering into another free trade agreement with yet another unstable Latin American nation. In Europe, people point to the experience of the EEC, European Economic Community. Well, the EEC demanded labor protections, environmental protections, and some actual democracy and stability before it allowed in certain other nations, particularly Portugal, Greece, and others.

We are entering into these immediate agreements with countries without any labor protections, without any substantial environmental protections, and in the case of Mexico, without any democratic reforms. I would question the wisdom of extending this agreement to yet another country.

I would question whether or not that means we are going to extend the same bailout privileges to Chile that we have extended to Mexico and have the same sorts of obligations. We have already weakened the dollar dramatically by so closely linking our currency to the peso. Again, as a critic of NAFTA, I said, as did many others, that the peso was overvalued, and that there would be a devaluation after NAFTA. Of course, we were wrong. We could not predict that it would be a 40-percent devaluation. We thought it would be perhaps 20 to 25 percent.

So what I would point the subcommittee toward is we are headed in a direction that is not a benefit to the American economy nor to the people of Mexico. Unemployment is growing dramatically in Mexico. Inflation is rampaging out of control. Mexican wages are reduced in real terms, American jobs are being lost, and we are paying $20 billion for the privilege.

So I would question the wisdom of extending the same treatment to Chile at a time when our policy in Mexico has proven to be such a dismal failure.

I thank the chair for the time and will remain after the panel for any questions you might have.

[The prepared statement follows:]

STATEMENT OF CONGRESSMAN PETER DEFAZIO

TO THE SUBCOMMITTEE ON TRADE OF THE HOUSE WAYS AND MEANS COMMITTEE

June 21, 1995

I want to thank the Chairman of the Subcommittee for giving me the opportunity to speak out on an issue of great importance. The Roman statesman Cicero once said, "Any man can make mistakes, but only an idiot persists in his error." NAFTA has been worse than a mistake; it has been a dismal failure by any and every measure. To even begin to consider repeating this failure by expanding this turkey is nothing short of idiocy.

I have been and continue to be an opponent of the North American Free Trade Agreement. It has been bad for our economy, our workers, and our trade deficit. I strongly oppose Chile's inclusion into NAFTA and would ask this subcommittee not support this proposal.

NAFTA's record shows that the agreement has been an abysmal failure. NAFTA promised job growth, with some claiming that NAFTA would create 100,000 jobs in its first year. In fact, NAFTA has been a job loser. A recent analysis by the University of Maryland shows that 16,873 jobs were eliminated in 1994 as a result of increased trade with Mexico and that with the sharp decline in the peso, at least 219,000 more US jobs could be eliminated in 1995.

NAFTA promised a trade surplus, but for the first time in four years we have a trade deficit with Mexico. This ballooning trade deficit could exceed $20 billion this year, putting Mexico up with China and Japan as our biggest trade problems. In the first three months of 1995, the merchandise trade deficit with Mexico totaled $3.8 billion. Record imports from Mexico will continue to add to our mounting trade deficit. The Administration claims that every $1 billion in trade equals roughly 20,000 jobs. A $20 billion deficit equals staggering job losses.

American workers in the manufacturing industry have been the big losers with net export of manufactured products, including electronic equipment, cars, medical equipment and apparel.

It's not hard to see why NAFTA has been so bad: the Mexican economy is a disaster. Throughout the debate on NAFTA, many of us were concerned about the viability of the Mexican economy, including the overvaluation of the peso and its link to the U.S. financial system. The peso's January collapse was no accident as the Mexican government was propping up the peso in order to sucker the US Congress into approving NAFTA. The Mexican peso devaluation has seriously eroded the buying power of the Mexican workers, with American products even more out of reach for consumers. The Los Angeles Times reported on April 20 that the Mexican economy lost more than 700,000 jobs in January and February alone. Higher interest rates and inflation -- which is expected to be 50 percent in 1995 -- will continue their economy's gloomy prospects.

Even when Mexican workers are employed and the peso is stable, their ability to help jumpstart the American economy is a myth. At the average maquiladora wage of $1.15 an hour, it would take about six and a half years for a Mexican worker to buy a Ford Taurus -- provided, of course, the worker doesn't eat, buy clothes or provide shelter for his or her family.

NAFTA was enacted on the premise that in order for the US to compete, we must do like the Europeans and form larger markets for our products. If the President and the Congress are insistent about expanding NAFTA, at least let's do it the same way the Europeans expanded the European Community.

The EC did not spring up during one year or one decade, but was put together deliberately over 40 years. And it wasn't until recent times that many nations -- namely Greece, Portugal and Spain were included. Why? Because until recently they were dictatorships, countries without democracy, with lower standards for workplace health and safety, less stringent environmental laws and a poorer standard of living than the rest of Europe.

The European countries said "we don't want to enter into free trade agreements with you because all of our businesses will move to your countries." Europe required them to become democratic. They required them to adopt worker health, safety and environmental laws. They helped foster democratic leadership and institutions. We cannot afford to rush into a new agreement without looking carefully at the full impacts, not only in this country, but in Chile. What would the effects be on Chile's forests, which are being consumed at an enormous rate? Or on their agricultural practices, in which agricultural chemicals that were banned for sale in this country are exported to Chile for use on their crops, only to be imported back here? Or what about human rights, where a brutal dictator, Augusto Pinochet, remains commander-in-chief of the Army, and has the ability to shield his secret police thugs from the "justice" system? These questions must be addressed before expanding this treaty.

I've been joined by my colleagues Congresswoman Marcy Kaptur and Congressman Duncan Hunter in asking President Clinton to "forgo further negotiations to expand NAFTA until you can demonstrate that the current agreement is providing a net benefit to U.S. workers and the U.S. economy and that expanding the agreement is likely to do the same." We have yet to hear a response.

To me, that is the bottom line. Until the proof is in on NAFTA, I can see no reason to expand it.

NAFTA has not been a good deal for America. Not only do working Americans get to lose hundreds and thousands of jobs in the name of free trade, but we also -- with the huge bailout of the peso -- get to pay $20 billion for this pleasure.

Thank you Mr. Chairman and members of the Subcommittee for this opportunity to share these thoughts.

Chairman CRANE. Thank you.
Congresswoman Woolsey.

STATEMENT OF HON. LYNN C. WOOLSEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. WOOLSEY. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am also grateful for the opportunity to testify before the subcommittee this morning on Chile's proposed membership in the North American Free Trade Agreement.

Mr. Chairman, as a Representative of the Sixth District of California, home of many world renowned vintners and wine grape growers, I am here today to urge you to ensure that there is no further reduction of the U.S. tariff on wine in any trade agreement with Chile.

The U.S. wine industry is struggling under current international U.S. Government policies which indeed have established tariffs on wine at the lowest level of any major wine producing country. These low tariffs have enabled Chilean wine to flood the U.S. market, causing the wine producers in California and in other States to lose a significant share of the U.S. market. Yet, the Chilean wine industry remains unthreatened by the U.S. wine producers, since Chilean markets are so small they hold little promise for U.S. wine growers and the wine industry.

Mr. Chairman, in addition to current tariff disadvantages, U.S. wine producers are operating with a cost disadvantage, as well. The cost of land and labor needed for grape growing are extremely low in Chile, whereas, in the United States producers must pay top dollar for prime land and efficient labor. This cost disadvantage, along with the already low tariff, has caused the small wine producers I represent in Sonoma and Marin Counties to struggle to compete and survive. Lowering tariffs even more could prove to put an end to their survival altogether.

Mr. Chairman, a free trade agreement with Chile that lowers wine tariffs further will ensure that Chilean wine producers grow richer and more prosperous at the expense of the hard-working vintners and growers of California and throughout the Nation. The wine producers of Sonoma and Marin Counties are not opposed to free trade. They simply ask that you ensure that it is fair and, Mr. Chairman, so do I.

Thank you, Mr. Chairman, for your consideration.

Chairman CRANE. Thank you, Congresswoman Woolsey.

With that, we will commence questioning. Mr. Hancock.

[No response.]

Mr. THOMAS. Mr. Chairman, might I ask a unanimous consent request?

Chairman CRANE. Yes.

Mr. THOMAS. I have a written statement and I had prepared to make a statement. But in lieu of the fact that I was held up doing other things, I would just ask unanimous consent that my written statement be made a part of the record.

Chairman CRANE. Without objection, it is so ordered.

[The prepared statement follows:]

Statement of the Honorable
BILL THOMAS
Subcommittee on Trade
June 21, 1995

Mr. Chairman, I am looking forward to the testimony the Subcommittee will receive on the proposed U.S.-Chile free trade area. This will be the third such agreement my California constituents will have confronted and it is perhaps the most problematic. Chilean agriculture is the mirror image of California's. Indeed, some California farmers do business in Chile because the Chilean season for many products complements our own. Others, however, are concerned about Chile's past performance in certain areas and it is those concerns I will use to judge any agreement in this area.

Chile's prominence in perishable crop exports has raised questions for California agriculture. For example, the State's wine industry, the nation's largest, is concerned about Chilean producers mislabeling their product's variety. U.S. vintners market on the basis of product quality and do not want to compete with an inappropriately labeled wine. Chile's process for imposing sanitary and phytosanitary standards is nontransparent, making U.S. specialty crop exports to Chile harder because exporters have little or no warning of new restrictions. California farmers are increasingly reliant on new varieties of plants and animals as a means of providing a high quality product. Chile has no law allowing the protection of the types of intellectual property that the U.S. uses to protect these products of agricultural research. Adding these factors to Chile's small population and per capita GNP makes the California farm community wonder why the U.S. would want an agreement with Chile, especially when Chile appears to have excluded agriculture from other bilateral trade agreements it has developed with Mexico and other nations.

I am pleased that Chile seems willing to "dock" under our North American Free Trade Agreement (NAFTA) agreement because the U.S. achieved what I consider to be reasonable concerns which must be addressed by any arrangement we strike with Chile.

Several of my concerns are already addressed by NAFTA and I expect NAFTA's provisions will not be bargained away in the name of "market access". For example, NAFTA requires that produce imported into the U.S. under the agreement must meet our quality standards. American growers spend a great deal on marketing. Marketing order quality standards assure uniform product, critical to repeat sales. All American producers have to meet these standards and Chilean growers can produce a high quality product or my friends in California would not do business there.

NAFTA also provides long transition periods provided for import-sensitive horticultural crops and other products, preserves U.S. scientifically-based health and phytosanitary standards and employs acceptable rules of origin and controls against transshipment. NAFTA has "surge controls" so important-sensitive perishable crop industries can gradually adjust to the integration of our economies. Chile's acceptance of these standards would be reassuring. This is not, however, an exhaustive list of what Chile must do to minimally address concerns I have heard expressed about this possible agreement.

Among the other steps Chile must clearly take is that of protecting all forms of recognized intellectual property, including patented or otherwise protected plants and animals. California farmers do not want their research made subject to misappropriation. Chile must also provide a transparent regulatory process on which U.S. exporters can rely for timely notice of changes in standards. Finally, Chile must regulate its industry in a way that assures U.S. industry will not suffer from unfair competition from misrepresented products. My primary focus is of course on the mislabeled wines but the principle should apply everywhere.

I have no doubt Chile can easily comply with each of these standards. This will be an extremely hard agreement for many California farmers to accept and failure to meet the standards I have enunciated will only make it harder for them to accept an agreement of this kind.

Chairman CRANE. Mr. Hancock.

Mr. Rangel.

Mr. RANGEL. Thank you.

Congressman DeFazio, do you believe that it is possible to save our investment in Mexico, assuming it is as bad as you think it is? Would not withdrawing from Chile and Central and South America escalate the lack of confidence people have with our trade agreement?

Mr. DEFAZIO. First, there is a difference between extending treatment to countries that are now not included, and Chile is not included. We are talking about extension, not withdrawing from the agreement, so I would question the wisdom of an extension when the policy is so questionable to begin with.

Mr. RANGEL. I meant exactly what I said. Our agreement with Mexico is a hemispheric thing, and so whether we are talking about Mexico or Central or South America, whether we are talking about shoring up the economy by strengthening the peso, all of these things are in for a dime, in for a dollar. I am not saying that it is right. I am just asking you, do you really think that denying admission of Chile would improve the trade deficit with the United States as relates to Mexico? I do not know the answer.

Mr. DEFAZIO. I think it would prevent further deterioration in the United States trade deficit by adding yet another country that would run a large trade surplus with the United States, not as large as Mexico, because the commerce is not as great.

But these agreements are designed to favor nations that do not observe labor rights, environmental laws, and other constraints, so clearly they become export platforms for the United States because just in the minor area of wine, as she points out, they do not have the same constraints. They can use pesticides and herbicides that are not approved in the United States; none of that is in these agreements.

Mr. RANGEL. So if we could just cut our losses in Mexico and just say that was a bad deal, do you think that is the best way we should go? Obviously, a broadening of the agreement would mean that other countries would put us in the same position along your line of thinking, so in addition to denying admission of Chile, you think the best thing to do is to pull out of Mexico, as well?

Mr. DEFAZIO. I believe we should renegotiate the treaty with Mexico and basically withdraw from the existing agreement. I believe it is defective. I believe it is not benefiting workers on either side of the border. It may be benefiting a few corporations and protecting their investments.

When you talk about abandoning our investments, the American people do not have an investment in Mexico except perhaps in a common bond between our peoples in trying to improve their standard of living and their conditions. That has deteriorated dramatically under NAFTA and the economic constraints under which that country is operating, and there is no promise it will get any better. They still cannot organize labor unions outside of the government. They are still not getting environmental protections in the maquiladora area. In the maquiladora area, they are licensing a plant every day. Things are getting worse.

Mr. RANGEL. I am new on the Trade Subcommittee. How do you go about renegotiating the agreement with Mexico?

Mr. DEFAZIO. Well, there is a simple 6-month out clause. I would exercise the 6-month out clause by either party and we could give 6 months' notice and then say we intend during those 6 months to negotiate a new agreement which includes true labor protections, environmental protections, and other basic reforms that we believe are necessary.

Mr. RANGEL. Thank you.

Thank you, Mr. Chairman.

Chairman CRANE. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

One of the things we ought not to do is revisit a lot of the bogus arguments that were present in the NAFTA round. I have some real concerns about bringing Chile in, and that is why I want to make sure that they are brought in under a docking process under NAFTA and not on a bilateral agreement.

I think there are a lot of unilateral decisions that Chile has to make to have access to our markets, and I am, probably as much or perhaps more than anyone, sensitive to the similarity of products that are produced in Chile.

I have long been involved in trying to coordinate these matters. There is some advantage to what I call seasonal complementarianism, if we can work it out, and grapes are a good example. They come in during the winter where we used to sell our stored grapes. They sell fresh grapes and it keeps the market active, and then in early April our grapes from the Coachella Valley begin coming in, and we then move to fresh grapes and they do not get to sell stored grapes. We are working it out.

Frankly, I am concerned about making sure that Chile joins the community of nations in the area of protecting intellectual property rights. I am concerned about honoring patents, including those for agricultural products, and I am fundamentally concerned about what I consider acts, not just against international trade, but those that are unethical and immoral, labeling products as something they are not. If that is an ongoing, widespread practice, then we have to get after it immediately.

Mr. DeFazio, I would share with you my concern regarding Mexico about some of the promises that were made about the changes that have occurred, especially in the judicial system and in other areas, or about the attempt to bring a degree of transparency to decisions and actions made in Mexico between friends, family, and others. That is an ongoing problem.

I am not saying that Chile has exactly the same problem, but I do believe there is a mental set that you get away with what you can get away with to a certain extent. I will be very concerned about the way in which our negotiators approach the kinds of conditions under which we enter into this relationship with Chile.

Frankly, from a California point of view, Chile is about equal to Los Angeles County in population, which means we are not going to get a whole lot out of a two-way trade arrangement. Chile stands to benefit far more.

What I see us getting out of these discussions is the ongoing process of ultimately drafting in, dropping in from the North Amer-

ican Free Trade Agreement and, through this process where Chile, Argentina, Brazil, et cetera, create an American free trade agreement. So I am supportive of it.

I am at the same time very concerned that we make sure that in the agreements that we enter into, we not only make sure that Chile joins the world community in terms of an honesty about work product, whether it be plant, vegetable, or mental, but they do not misrepresent products; that we understand that agreements between third parties, Chile and Mexico, for example, are going to be affected in the long run in an agreement between Chile and the United States.

If those conditions are met, I will not oppose bringing Chile in. But obviously the bar is going to be quite high, because, as I said when we started with Canada, as I said when we dealt earlier with Israel, this is a whole new process and we have got to get it right the first time or we will spend the rest of the time trying to correct it.

So I am very concerned, but at the same time I hope the dialog does not break into a reconstruction of the fact that pesticides are used down there that are illegal and the products get to come in. Frankly, we do our inspecting and no residue can be brought in on a product that is illegal.

I am concerned about getting the legal arrangements down correctly, so that they cannot engage in something unwittingly, or criminal elements or people who want to shade the picture can engage in. If we do our job, none of those things will occur.

I understand the sensitivities and concerns, but the idea of bringing both North and South America together in a larger mutually beneficial free trade area frankly is attractive enough for me to look over the shoulder of the negotiators to make sure they get this one right.

Mr. DEFAZIO. It is hard to parse a question out of a lengthy statement, but I would certainly find elements—

Mr. THOMAS. It is not a lengthy statement. I am only allowed 5 minutes. [Laughter.]

Mr. DEFAZIO. I certainly would agree about taking a hard-headed view, and I think the gentleman makes a particularly good point about the comparative size of the market. This is no tremendous boon for U.S. producers. It is like Mexico had the equivalent buying power, if every peso were used, of New Jersey. As you point out, Chile is even less significant in terms of our national economy, and we must be careful it does not become an export platform for things that violate copyright laws or other laws.

I would just urge the gentleman to check with APHIS, Animal and Plant Health Inspection Service, on the inspection program. When I checked on the importation of New Zealand lamb a few years ago, APHIS told me there was no particular program oriented toward the testing of imported products, that they have a general testing program, but they do not specifically test imported products for particularly prohibited pesticides even in the case of lamb, when we can point out we know it was used. They said we do not test that way, so I would have that concern.

Mr. THOMAS. I will just share with the gentleman a brief history. My time has expired. I have a long involvement in the area of

APHIS and Customs in terms of the tariff codes, the movement of product between codes, the attempt to camouflage, the attempt to modify Aflatoxin in pistachios. Specialty agriculture is an area which represents almost 3 billion dollars' worth of value added in my district. I am very concerned, because, as I said, they have similar products, to create a scare in the market which would not only affect their products, but affect ours, as well.

You will recall the Chilean grapes delivered to the Philadelphia port, and I do not want to go back through that process, and, frankly, it affected everyone. So I have a very great concern about getting it right. Notwithstanding that, that does not mean you do not go forward with the process. It means what you do is you make sure you get it right.

Ms. WOOLSEY. Mr. Thomas.

Mr. THOMAS. Yes, ma'am.

Ms. WOOLSEY. What I would like to ask you to do, because you are making a lot of sense on that, is to consider the wineries and the grape growers that may not be in your district up front, instead of tacked on at the end like they were with NAFTA. NAFTA has just not done what it was supposed to do for the wineries and the wine grape growers. So add them to your list, even though they may not be in your district, if you would, please.

Mr. THOMAS. The gentlelady needs to know that I have been working with California interests long before she came to Congress. I have been working with them very, very closely for a number of years. Every time the U.S. Trade Representative, since the Reagan administration, actually since the Carter administration, has had a list of concerns given to them, every time they get on an airplane and go negotiate, whether it is Japan in terms of wine, whether it is the European Community, whether it is labeling, whether it is dealing with our own government about labeling and the rest, we have been involved.

I will tell you what I am not willing to do: I am not willing to create an advantage for American products unfairly. I am willing to go every step to make sure that there is a fair relationship. Obviously, mislabeling is a fundamental flaw, error, unacceptable behavior. We are hopeful there will be some experiments that will allow us to determine the variety of wine from the wine itself, and that would be a great success. Otherwise, you are relying largely on the representations of people that you assume to be honest.

Once again, I expect this U.S. Trade Representative, as every U.S. Trade Representative that I have talked to, to make sure that there is no segment of the American economy that is disadvantaged when we enter into a trade relationship. Frankly, I think they have done a pretty good job of it overall.

Sometimes you simply cannot get people to do certain things. Our segment of the market is not as large as we would like. If we were three-quarters of the market in the entire dollar exchange with Chile, then obviously we would have greater influence. They have done a good job, by and large. We will make sure they do a good job as we go forward.

My basic point—Mr. Chairman, thank you for the extra time—is that we have enough trouble dealing with the real problems in this moving forward with the bilateral agreement. I do not think

it serves any purpose whatsoever to raise red herrings that really never were there in the first place in previous agreements, and that they are not going to be here in this agreement. Let us work on the real world of problems.

To that extent, in your testimony where you clearly outlined areas we need to focus on, I appreciate your testimony.

Ms. WOOLSEY. Thank you.

Mr. THOMAS. Thank you, Mr. Chairman.

Chairman CRANE. Are there any other questions of these witnesses by Members on the dais right now?

[No response.]

If not, then we are going to recess briefly. This is a quorum call, followed by a 5-minute vote on the Obey amendment. I was informed that conceivably there may be a motion to recommit following that, and then final passage. So it is a little difficult to tell you when we are going to reconvene.

If you folks could touch down with me on the floor after we get that reading as to how quick that process will move, we may come back between the Obey vote and any motion to recommit and reconvene our hearings.

With that, the subcommittee stands in recess.

[Recess.]

Chairman CRANE. The subcommittee will come to order.

We will call the Hon. Charlene Barshefsky to testify at this time.

STATEMENT OF HON. CHARLENE BARSHEFSKY, DEPUTY U.S. TRADE REPRESENTATIVE, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Ms. BARSHEFSKY. Thank you, Mr. Chairman.

It is a pleasure to appear before you and members of the subcommittee today. I ask that my full testimony be accepted for the record.

Chairman CRANE. Without objection, it is so ordered.

Ms. BARSHEFSKY. Mr. Chairman, we have a historic opportunity to create jobs in this country to foster growth and stability in this hemisphere, and we have this opportunity by virtue of the President's commitment and the commitment of the 34 democratically elected leaders of our own hemisphere to create the Free Trade Area of the Americas by the year 2005, and we have this opportunity, as well, to an expansion of the NAFTA.

This administration has worked very hard to open markets abroad to U.S. goods and services and U.S. agriculture. We have negotiated in 27 months well over 100 trade agreements, including the historic Uruguay round multilateral agreement, the NAFTA itself, the APEC Agreement for free and open trade in the Asia Pacific region by the year 2010, and the Free Trade Area of the Americas Agreement to create a free trade area in our own hemisphere by the year 2005.

Despite these agreements, significant market access barriers remain, including in our own hemisphere, and we would like the opportunity to work with Congress as we move forward to eradicate those barriers.

The United States has a strong economic interest in moving forward with an ambitious and aggressive trade agreement agenda in

the Western Hemisphere. Let us consider what is at stake from an economic point of view for the United States. Latin America and the Caribbean is now the second fastest growing region in the world. U.S. exports to the region have exploded from $31 billion just 10 years ago to $93 billion in 1994, supporting over 600,000 new jobs in the United States. U.S. exports to Latin America, including Mexico, increased 71 percent from 1990 to 1994.

Mr. Chairman, over one-half of this country's merchandise trade export growth has come from our exports to Canada and Mexico. U.S. exports to Latin America and the Caribbean approximate our exports to the European Union. If trends continue, our exports will reach a level greater than our combined exports to the European Union and Japan.

Latin Americans spend on average 40 cents of every dollar on trade on U.S. goods. We supply over 70 percent of some Latin American countries' imports, and often three or four times as much as that country's next largest trading partner. Our exports of capital goods, which account for over one-half of U.S. exports to Latin America and the Caribbean, have increased dramatically.

Moving forward with Chile is one essential component of a two-part strategy to shape the Free Trade Area of the Americas. The Summit of the Americas hosted by President Clinton in December in Miami was a watershed in hemispheric relations. It placed the United States squarely at the center of the hemisphere's economic integration and renewed our leadership position. Our economic fortunes, our leadership in this hemisphere, however, will be determined in large part by the success we have in implementing the summit integration trade plan.

This administration is determined to move forward to begin building the Free Trade Area of the Americas. We will host the first ministerial under that process in Denver this month. But the negotiations of Chile's accession to the NAFTA is a second critical strategic step in this endeavor. If we are not able to complete Chile's accession expeditiously, others in the hemisphere will ask if we are able to lead the hemisphere overall in integration efforts. If we are not able to complete Chile's accession to NAFTA, our influence in the pace and scope of trade liberalization in our own hemisphere will be threatened.

Mr. Chairman, two successive Presidents, two different parties have been committed to the pursuit of a free trade agreement with Chile. If the United States seeks to broadly encourage stable growth, growth sustaining policies and the adherence to open markets, there is no better example than Chile, and let me cite just a few facts.

Chile was recently determined by the highly regarded Davos Economic Forum as the fifth most competitive emerging economy in the world. Chile's average economic growth rate since 1985 has been over 6 percent, putting it comfortably on a par with dynamic economies of the Asia Pacific rim. Chile's national savings rate was a strong 24 percent of GDP, gross domestic product—would that we had that kind of savings rate here in the United States—based in part on a significant contribution from Chile's private Social Security system.

Chile's national investment rate was an astonishing 27 percent of gross domestic product during 1990–93, the highest in the region, and this tends to be long-term investment. Chile has run a budget surplus for 8 straight years, with public savings accounting for almost 5 percent of GDP in 1994, and foreign reserves high and rising.

Since Chile has become a democracy, it has pulled 1 million people out of poverty, that is out of a total population of 13 million. The equivalent in the United States would be to see 18 million people rise from poverty. Chile has one of the most aggressive free trade and trade expansion agendas in Latin America.

Chile's trade with the United States, although small relative to other countries, has climbed dramatically during the 1992–94 period. Our exports of motor vehicles are up 35 percent. Our exports of Earth-moving equipment are up 46 percent. Our exports of computers and related equipment are up 28 percent. Our exports of telecommunications equipment are up 55 percent. Our exports of medical equipment and technology are up 33 percent.

Almost one-quarter of everything Chile imports, it imports from the United States, and the range of products that are imported compare very favorably with that range of products to other far more developed economies.

Negotiating Chile's accession to the NAFTA will remove significant remaining barriers that impede U.S. exports to Chile and further increase the potential for additional export gains. There are a number of issues to which we will seek removal of Chilean barriers. But Chile's accession also signals U.S. leadership in this hemisphere, a desire to expand U.S. principles of free trade and market economics throughout the hemisphere, a bridge between the United States and South America that will be vital to this hemisphere's stability and economic growth. Chile's importance extends far beyond even its impressive economic gains.

Mr. Chairman and members of the subcommittee, although we do not have fast track in place now, consistent with past practice for agreements subject to fast track, the administration has continued the practice of soliciting the advice of the U.S. International Trade Commission, the advice of our private sector advisory committees, which are statutory, the advice of the public, and we have welcomed additional advice from any interested parties which they may wish to provide.

USTR will coordinate the negotiation effort working with an interagency team of experts in the negotiation of these agreements, many of whom negotiated the Israel agreement, the Canada agreement, and the NAFTA itself.

Mr. Chairman, for all the reasons indicated in my testimony today and in my written statement, a free trade area with Chile and Chile's accession to the NAFTA is absolutely in our national interest. Benjamin Franklin once said that no nation was ever ruined by trade. American workers understand that. We do not fear open and fair competition, but we do insist on fairness, we do insist on equity, and we do insist that in a global economy our trade agreements are a single undertaking. Everyone plays by the same rules, with reciprocal benefits and reciprocal obligations.

I would be pleased to answer any questions the subcommittee may have.

Thank you.

[The prepared statement follows:]

Testimony Before the
Trade Subcommittee
House Ways and Means Committee
June 21, 1995
Ambassador Charlene Barshefsky
Deputy United States Trade Representative

Introduction

Mr. Chairman and Members of the Committee, I appreciate the opportunity to discuss the importance of a free trade area with Chile. We have a historic opportunity to create jobs in this country, and foster growth and stability in this hemisphere.

The goal of U.S. trade policy is to create jobs and raise standards of living in the United States, to foster global growth, and to build global stability. As we approach a new century, the future prosperity of the United States more than ever before depends on our ability to compete and win in the global economy. There is no possibility of avoiding this new challenge.

Where our economy was once largely self contained, we are now increasingly interdependent with the rest of the world. This change began decades ago, but has accelerated in recent years. Twenty-seven percent of our economy is now dependent on trade.

The global economy offers tremendous opportunities for American workers. Over 11 million workers in this country owe their jobs to exports. These jobs pay higher wages, on average, than jobs not related to trade. Every billion dollars of exports supports 17,000 jobs. Clearly, expanding trade is critical to our effort to create good, high-wage jobs.

The United States has a mature economy -- and only four percent of the world's population. Future opportunities for growth here at home lie in selling goods and services to the other 96 percent. Given this fact, opening markets, expanding trade and enforcing our trade agreements are critical to fostering growth here at home.

Since taking office, the Clinton Administration has demonstrated a clear commitment to opening markets and expanding trade. With bipartisan support in Congress, we completed and secured the approval of the North American Free Trade Agreement (NAFTA) creating the largest regional free trade area in the world. We completed the Uruguay Round negotiations. A bipartisan coalition in Congress voted to implement its results which lower barriers to trade and strengthen the global trading system, creating growth and jobs in the United States. We negotiated the Summit of the Americas Declaration and Action Plan that is designed to lead to the creation of the Free Trade Area of the Americas (FTAA) by the year 2005. We negotiated the Bogor Declaration which sets for the objective of free and open trade among the Asia Pacific Economic Cooperation (APEC) members. We set our negotiations with Japan on a new course under the Framework Agreement, completing fourteen trade agreements to open their market to U.S. exports, and are now working diligently to open Japan's closed autos and auto parts market. In addition, we concluded the largest procurement agreement in history with the European Union, an agreement covering 80 percent of global shipbuilding, an historic intellectual property rights agreement with China, and scores of other bilateral trade agreements.

Mr. Chairman, for all the hard work of the last two and a half years in opening markets we still have much to do. Formal and informal trade barriers still exist around the world to limit U.S. exports. This, in turn, hinders growth and job creation in this country.

Chile: The Case for Moving Forward

The United States has a strong economic interest in moving forward with an ambitious and timely trade agreement agenda in the Western Hemisphere. Ambassador Kantor made clear in his May 17 testimony on fast-track - itself a vital component for U.S. success in this hemisphere and the global economy - why moving forward is essential, but allow me to explain why it is particularly important to move forward with Chile now.

Moving forward with Chile is one essential component of a two part strategy to shape the

critical initial elements of the FTAA. One element of this strategy is based upon the building of stronger trade relations with all of the countries in the hemisphere, both bilaterally and through the larger sub-regional trade arrangements to which they belong. In this connection, the progressive liberalization of trade and improved disciplines in a range of areas is critical. The Administration is now preparing for a meeting at the end of the month in Denver with the rest of the western hemispheric Ministers responsible for trade to lay the initial groundwork that will move us in this direction. This is the first important hemispheric step in the post-Summit of the Americas trade action plan. We expect to set in motion in Denver a process that will lead to major new economic opportunities for the United States and the hemisphere.

The other element of an overall strategy in the hemisphere is NAFTA accession. Not only are we moving to strengthen mutually beneficial ties across the hemisphere, but we are moving to strategically influence the structure of those ties in the near term. NAFTA accession is central to that objective. The hemisphere contains numerous sub-regional free trade arrangements reflecting a diversity of objectives and traditions that are largely uninfluenced by the United States. In fact, Latin America has a significant trade agreement history over the last four decades. In recent years these efforts have become more comprehensive. For example, the Southern Common Market, or MERCOSUR - which accounts for over half the gross domestic product of Latin America - is an effort to create a customs union and eventually a common market. It is critical that the United States contribute tangibly to this ongoing sub-regional process to balance and help shape the free trade agreement agenda in Latin America. Only in this way will the United States ensure U.S. exporters, service providers and workers a fair shake at the second fastest growing markets in the world.

In addition, building a comprehensive trade relationship with Chile has broad strategic trade policy attractions. Chile is negotiating a free trade agreement with MERCOSUR. Chile is also a member of the APEC. Chile is both a trade policy gateway to MERCOSUR and South America and the Chile's accession to the NAFTA will bring to four the number of APEC members participating in North American free trade.

For many years the United States had a very limited trade relationship with Latin America, one that held little promise for the future due to Latin America's inward looking economic and trade policies. Now that has dramatically changed. A market-based economic policy transformation, coupled with a renewed commitment to democracy has turned a region with little promise into a region that inspires. Officials from the World Bank, for example, just issued a report indicating that growth in Latin America could accelerate to more than six percent per year over the next few years, thus providing significant new opportunities for our exporters. U.S. exports to Latin America already approximate our exports to Western Europe, and if current trends continue they will exceed those to Western Europe and Japan combined by the year 2010. This upward trend and the opportunities that it has brought - over 600,000 higher than average paying U.S. jobs since 1985 - will only be sustained with sound macroeconomic policymaking in Latin America and the United States and an aggressive and ongoing effort to open closed markets to the benefits of unimpeded trade. Many of our competitors, including the EU, have also noticed the prospects for major trade gains and are acting to ensure their interests are protected with their own trade agreement strategies with the region.

Chile is a country in which two successive Presidents have been committed to the pursuit of a free trade area. No other country in Latin America has a better record of economic accomplishment in the last ten years than Chile. If the United States seeks broadly to encourage stable, growth-sustaining policies and the adherence to open markets there is no other country in the region better qualified in which to build the strongest trade relations. Chile weathered a very difficult period in the early 1980s characterized by dramatically reduced economic output and an unemployment rate of 20 percent. It learned valuable lessons regarding the management of its economy which serve it well today. Chile's economic accomplishments are outstanding.

Let's examine some facts:

- Chile was recently voted by the highly regarded Davos Economic Forum the fifth most competitive emerging economy in the world;

- Chile's average economic growth rate since 1985 has been over 6 percent putting it on par

with the most dynamic economies of the Asian Pacific Rim;

- Chile's growth rate in the first quarter of this year was 6.6 percent, with inflation at 7.4 percent on an annualized basis continuing its downward trend and unemployment continuing to trend downwards at 5.3 percent;

- Chile's currency has been appreciating against the dollar;

- Chile's market-based economic policies have lifted over one million people out of poverty since the transition to democracy -- out of a total population of over 13 million;

- Chile pioneered Latin America's comprehensive privatization efforts;

- Chile's national savings rate was a strong 24 percent of gross domestic product during the 1990-93 period, based in part on significant contributions from Chile's private social security system;

- Chile's national investment rate was an astounding 27 percent of gross domestic product during the 1990-93 period, the highest in the region;

- Chile has run a surplus in its national budget for eight straight years with public savings accounting for almost five percent of gross domestic product in 1994 and its foreign reserves are high and rising;

- Chile's financial system is strong - the Chilean banking sector averaged 19 percent profitability on an annual basis over the last 10 years and Standard and Poor's recognized its banking supervisory bureau as the best in Latin America;

- Chile's trade regime is characterized by a uniform tariff rate of 11 percent ad valorem across the board with virtually no quantitative restrictions;

- Chile was the first developing country to bind its tariffs across the board in the Tokyo Round of multilateral trade negotiations in 1979;

- Chile was an active contributor to the Uruguay Round of multilateral trade negotiations;

- Chile is a new and valued member of APEC; and

- Chile has one of the most aggressive free trade agreement agendas in Latin America, having concluded agreements (which address primarily tariffs and quantitative restrictions) with Mexico, Colombia, Venezuela and Ecuador and less comprehensive agreements with Argentina and Bolivia. In addition, and as indicated earlier, Chile is negotiating a free trade agreement with the MERCOSUR, but has also proposed an agreement with the EU.

United States - Chile Trade: A Model

U.S. - Chile trade has increased dramatically. The vibrancy of the trade relationship is an example we would hope to repeat across the region. U.S. exports to Chile quadrupled during 1985-94, growing from $682 million to $2.8 billion. Last year, the U.S. ran a trade surplus with Chile of nearly $1 billion. During the 1992-94 period, U.S. exports of:

- motor vehicles increased 35 percent;

- earth moving vehicles increased 46 percent;

- computers and related equipment increased 28 percent;

- telecommunications equipment increased 55 percent; and

- medical equipment increased 33 percent.

The Accession Negotiations

Negotiating Chile's accession to the NAFTA will remove significant remaining barriers that impede U.S. exports to Chile and thus further increase the potential for additional export gains. The NAFTA and its related agreements cover a broad spectrum of disciplines and Chile's adherence to these rules will help to upgrade trade and regulatory practices and policies in Chile that will ensure a continually growing and mutually productive trade relationship.

In the best tradition of working in partnership with the Congress, we look forward to discussing the issues relevant to this negotiation with this Committee and other relevant Committees as we proceed.

Consistent with past practice for agreements subject to fast track, the Administration has solicited the advice of the U.S. International Trade Commission on the economic implications for the United States of Chile's accession to the NAFTA. We will consider the Commission's advice carefully. We have also solicited and received advice from our official advisory committees, including from the membership of the Advisory Committee on Trade Policy and Negotiations (ACTPN) and the sectoral and functional committees. Our negotiators will continue to seek the views of the advisory committees as we proceed. The Administration has also sought and received advice from the public and welcomes any additional advice interested parties wish to provide.

Based upon the President's joint statement of December 11, 1994 with the leaders of Canada, Mexico and Chile, we have now officially launched the accession negotiations. In announcing the formal commencement of talks in Toronto on June 7, Ambassador Kantor and his counterparts set guidelines for negotiators from the four sides that will ensure a rapid and successful launch. USTR will coordinate the negotiation effort working with an interagency team reflective of the expertise of particular agencies and individuals. Consistent with the Ministerial Guidance, for example, lead negotiators from the four countries will be exchanging tariff and trade data by the end of this month. The first round of negotiations to discuss individual NAFTA chapters will occur in July with talks commencing through the summer. Negotiators will report to Ministers in September on progress achieved. Ministers will meet as necessary to assess the progress and determine the next steps in the negotiations.

The Administration believes it essential the United States move forward in a timely and constructive manner successfully to negotiate Chile's accession to the NAFTA and its related agreements. We look forward to working closely with this Committee and others as we progress.

Conclusion

A free trade area with Chile is in our interest as well as Chile's. It will create jobs and economic opportunities in both countries. It will strengthen our relationship with a key friend in the Americas, and serve as a bridge to forging hemispheric prosperity.

Benjamin Franklin once said, "no nation was ever ruined by trade." American workers understand that. Americans do not fear open and fair competition. But we do insist that our trade agreements are "single undertakings" where everyone plays by the same rules.

We ask for -- we insist on -- a level playing field in trade because it is the right and fair thing to do, and because it is in the best interest of all nations.

As a nation, we are at our best when we reach out and face new challenges. I look forward to working with all of you in the days and months ahead as we strive to foster growth, create jobs and lay the foundation for the 21st century. Thank you.

Chairman CRANE. Thank you, Ms. Barshefsky.

I know it was December 7 when the three amigos of NAFTA agreed to try and advance the idea of Chilean accession. I am curious, have our Mexican and Canadian negotiators counseled you in any way about going slow on trying to get Chile into our free trade agreement?

Ms. BARSHEFSKY. Not at all, Mr. Chairman. As you may know, the four trade ministers, that is the trade ministers are our NAFTA partners and the Chilean Finance Minister, met in Toronto on June 7 to formally inaugurate the NAFTA accession talks. This followed seven preparatory meetings between our working groups for the negotiation, as well as Canada's, Mexico's and Chile's. We all share a common mind that this accession is important and can be done rapidly.

Chairman CRANE. What in your estimation will be the impact of Chilean accession into a hemispheric free trade agreement with regard to advancing U.S. and our neighbors' interests, in contrast to some of the subdivision that exists at least in South America right now, MERCOSUR I am thinking of specifically? What significance do you attach to this?

Ms. BARSHEFSKY. We think that it is very significant. Chile provides a potential bridge between the NAFTA partners and the MERCOSUR partners. As we negotiate this arrangement with Chile, Chile will also be negotiating with MERCOSUR. That provides some potential benefits.

In addition, as I have indicated, Chile's accession demonstrates that the United States is serious not only about hemisphere integration, but serious that the United States takes the lead in ensuring that that process is to the benefit of open trade, of fair trade.

Chairman CRANE. We have heard testimony that at least implicitly tried to advance the argument that NAFTA in some way contributed to the peso devaluation. Would you sketch for us briefly the underlying causes of the peso crisis and, more importantly, why it was not caused or made worse by our free trade agreement with Mexico?

Ms. BARSHEFSKY. Mr. Chairman, I think the Treasury Department could give you a much more accurate view of why the crisis happened, and I do not feel as equipped in terms of macroeconomics to address that. But I can tell you what the NAFTA has done in the wake of the crisis, that is that the NAFTA has provided an underpinning to Mexican market openness with respect to Canada and the United States.

When Mexico went through a similar peso crisis in 1982, it dramatically increased its tariffs, it nationalized its banks, it took over a number of enterprises, and made a number of other protectionist and market-distorting decisions. The NAFTA prevents that kind of action being taken by Mexico, particularly in relation to U.S. exports and Canadian exports to Mexico.

The result that we see now is a Mexico that has tightened its fiscal policy, a Mexico that has continued the program of privatization, rather than State control, and indeed accelerated its program of privatization, a Mexico that has tried to shore up its short-term debt through the facilities the United States and others have provided, a Mexico that has continued to implement the NAFTA, re-

ducing tariffs and opening markets, and a Mexico that cannot turn back the clock and become protectionist as it had in 1982.

NAFTA has never been a guarantor of Mexican economic performance. If this crisis had happened and we did not have NAFTA, our exports to Mexico would suffer, as would those of other countries, because of the reduced purchasing power of the average Mexican. But NAFTA ensures that the free trade gains that we have achieved are preserved, and it ensures that Mexico will remain on a market opening and market liberalization course.

Chairman CRANE. We will have testimony later that the chapter 19 dispute settlement procedure in the NAFTA should not be extended to Chile, and in my view the NAFTA panel process has been largely successful and has worked fairly well to resolve trade disputes between Canada and the United States. Can you address some of the criticisms of chapter 19?

Ms. BARSHEFSKY. Yes, I can. Our view is that chapter 19 by and large has worked very well and very smoothly, operating much as it is intended to operate. There have been a few highly publicized cases in regard to chapter 19 and some concerns raised, and there is now a NAFTA working group that is looking at ways in which to make chapter 19 more efficient and is also looking at questions of ethical conflict on the part of panelists and how those kinds of issues can be addressed more effectively.

But let me say a word about the importance of chapter 19 as we look ahead into the hemisphere. The United States is no longer the principal user of antidumping and countervailing duty measures. The European Union takes such measures more frequently than the United States. Mexico takes such measures more frequently than the United States. Other Latin American countries are also becoming more aggressive users of dumping and countervailing laws, as indeed are some Asian countries.

The U.S. exporters need to be sure that, as we enter into these agreements, they have an effective form for the redress of their claims of nondumping or nonsubsidization. In addition, we need to be sure that we are able to discipline other countries' uses of dumping and countervailing duty laws. Many other countries do not have the legal tradition of due process and transparency that we do in this country, and chapter 19 is very effective on both of those scores.

Chairman CRANE. Thank you very much.

Mr. Gibbons.

Mr. GIBBONS. I am glad to hear you say the things you did about chapter 19. I would only point out that one of the provisions of chapter 19 was that we would sit down with the Canadians and negotiate a common set of antidumping and countervailing duty laws, and that has never been successfully carried out. I do not want to cast blame at anyone, but for a long time that attempt to get common antidumping and countervailing duty laws was postponed because of the World Trade Organization operation.

I think the time is now past when we have to hold our breath about the World Trade Organization and we ought to go back and very seriously try to work out a set of common agreements between United States-Canada, United States-Mexico, United States-

anybody else as to what are the commonly accepted countervailing and antidumping duty laws.

It may be that in actual practice that has all been superseded by the World Trade Organization, but I think we need to work on that subject matter a little, and I would call that to your attention and ask you all to put that on the agenda. Perhaps, Mr. Chairman, we may have some oversight hearings a little later on on that particular provision.

I am pleased with the way chapter 19 has worked. I think it broke the deadlock between the United States and Canada, and I think it is a good plausible way to solve our international disputes. I recognize its shortcomings, as well as its attributes.

You all are doing a good job down there, Madam Ambassador, and just keep up the good work.

Ms. BARSHEFSKY. Thank you very much, Mr. Gibbons.

May I say in response to your comments that there is a trade remedies working group in the NAFTA that is looking at issues of antidumping law and countervailing duties, and we would be pleased to keep you and the subcommittee informed of the progress of that group.

Mr. GIBBONS. Thank you.

Chairman CRANE. Thank you.

Mr. Hancock.

Mr. HANCOCK. No questions.

Chairman CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

It is refreshing when we can work together in a bipartisan pragmatic way on these important trade issues. I wish that could permeate some of the other issue areas before Congress.

Let me ask you this, Madam Ambassador: How can U.S. negotiators, in your judgment, best ensure that intellectual property rights are protected with Chile as a partner in NAFTA?

Ms. BARSHEFSKY. Mr. Ramstad, I have spent some considerable time on intellectual property rights issues. This is an area of grave importance to the United States because of the lead that the United States has in so many areas of high-technology and the creativity of so many of our different industries, including in the copyright sector.

There are a couple of points to be made here in connection with Chile's accession. First of all, we think through NAFTA accession we will see some improvement in Chilean intellectual property rights laws, particularly in the pharmaceutical sector, that we have long sought. For example, pipeline protection—as well as the length of the patent term—these are areas that are critical under the NAFTA and are clearly spelled out there.

In addition we have the Uruguay round TRIPs agreement coming into force. That will set in some areas higher standards than in the NAFTA, and we are going to have to look at that carefully to ensure that we capture the full benefit of all of the agreements that we have previously negotiated in this area.

In addition, Chile is itself making moves to upgrade its intellectual property rights regime, and let me give you one example. Chile's patent law does not protect new plant varieties. There is a convention, the UPOV, International Convention for the Protection

of New Varieties of Plants, on this issue and Chile was not a member, and this was of great concern to us. Chile in October 1994 passed a law that would engender this kind of protection of new plant varieties. They submitted documentation to the UPOV Convention, and in April of this year has learned that their law is acceptable and would provide the kinds of protections that are necessary.

So through NAFTA accession, through looking at the Uruguay round gains and through Chile's own unilateral actions to upgrade its intellectual property rights regime, we expect to see significant improvement, and that is what we will strive for.

Mr. RAMSTAD. I appreciate that response, Madam Ambassador. Perhaps my next question does not meet the germaneness test, but I cannot resist asking if you could provide us a brief update on the trade talks with Japan.

Ms. BARSHEFSKY. I am delighted to do that. Our negotiators will meet in Geneva tomorrow and Friday. The Japanese and we have agreed there are no preconditions to these talks, that is to say all issues are on the table. We have indicated to the Japanese that we expect these talks to be fully substantive, we expect the Japanese to come forward with meaningful proposals which they have failed to do for the last 20 months.

We have also emphasized to Japan, as President Clinton did with Prime Minister Murayama in Halifax at the G–7 summit, that our course is set, that if there is not an acceptable agreement by June 28, we will impose 100 percent tariffs on Japanese luxury vehicles. We do not relish the thought of doing that. We would prefer a negotiated solution. We believe it possible at this point that Japan would prefer a negotiated solution. We will strive for that in Geneva next week.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Chairman CRANE. Mr. Matsui.

Mr. MATSUI. Thank you very much, Mr. Chairman.

I would like to thank Ambassador Barshefsky for her testimony today, and obviously for all the work she is doing both on this issue and certainly the issue with respect to Japan at this particular time. We really appreciate your efforts there.

I just have two series of questions. One is in terms of the fast track issue. We understand the Chilean Government has indicated—I believe this was in Toronto in early June—that they really want fast track before they will be willing to conclude any agreement. Is that confirmed by your office? Second, where does that place the negotiations?

I am assuming that we are going to get fast track this year, but obviously that is not necessarily correct. Where does that place these discussions? Are they preliminary, very preliminary now? Are we looking at the end of this year? I do not mean to set a date, but just some idea.

Ms. BARSHEFSKY. Mr. Matsui, first of all, your understanding is correct with respect to the Chilean view. We intend to commence formal negotiations mid-July, at which point we will begin the process of data collection and data exchange in a range of areas. We have set up working groups. They will each have a schedule.

The working groups are based on the various NAFTA chapters, as well as on the supplemental agreements.

While we do not need fast track to start these negotiations, as we did not have fast track for the Uruguay round, as well as for the Israel agreement, there is no question but that we will require fast track authority to complete these negotiations and to move forward to expand the NAFTA and to retain our leadership in hemispheric integration.

Mr. MATSUI. Thank you. I have one final area, and this is on a sector issue and it deals with California wine or wine in the United States, as you put it, to be less parochial. During the NAFTA debate, that issue did come up, because the phaseout of the tariff in Mexico was 10 years, and for Chilean wine it is 3 years. Many of us who strongly supported NAFTA, with obviously the cooperation of the administration, decided that we wanted that issue to be put aside, and so in good faith all of us put this issue aside, much to the concern, obviously, of the wine industry, both in Texas, California, and throughout the United States.

This issue now has become very critical, given the fact that Chilean wine has come into the United States at a very high rate. We all agree that free trade is very important, but we do not want to protect barriers against our wine going out into Mexico, Chile, and these other countries. I understand your office, you, and Ambassador Kantor are working very diligently in trying to find some way to open this issue up, and I understand the Mexicans have been the problem. They do not want to open up NAFTA.

But I have to say that unless this issue is dealt with, there are going to be a lot of Members, in California particularly, who will be very unhappy, no matter how the agreement is crafted, and no matter how important this is to the United States, Mexico, Canada, and all the Western Hemisphere countries.

I am not speaking to you as much as I am trying to send a signal to the Mexicans and also to the Chileans that this issue really needs to be resolved in a satisfactory way, so that everybody can claim a victory. If it is not, I am afraid it could create a substantial problem for many of us who, although do not want to be seen as protecting a sector, feel that equity must be done, particularly in this area, since we did forego our efforts in 1993.

Ms. BARSHEFSKY. Mr. Matsui, let me say that your comments are well taken and your attitude is well taken. This is a sector where there is plainly a lack of balance and a lack of equity. There is a problem with respect to the Mexican market, that is that Chilean wine will enter the Mexican market beginning in 1996 duty free. U.S. exports into Mexico of wine will not achieve duty-free treatment until the year 2003, and our 1996 duties will be 16 percent. This is an unacceptable situation. It is an inequitable situation.

We also have a question about the relative tariffs between the United States and Chile, which is to say that the United States tends to have lower tariffs with respect to wine imports than Chile with respect to wine imports. That is also not an acceptable situation.

We will work very hard on this issue, not only because we do on all sectoral issues, but because this is also an inequitable and unjustifiable situation from the point of view of the United States. I

believe that the Chileans understand the importance of this issue to us. I believe Mexico is beginning to understand the importance of this issue to us and to the smooth functioning of the NAFTA, and we will be working with them on this issue and with you and other Members of the California delegation on this issue.

Mr. MATSUI. Thank you very much.

Ms. BARSHEFSKY. Thank you.

Chairman CRANE. Mr. Zimmer.

Mr. ZIMMER. Thank you, Mr. Chairman.

Madam Ambassador, we will have testimony from business groups later today that NAFTA accession negotiations for Chile should not be a lengthy process because of Chile's relatively open market and the fact that NAFTA is already up and running. How long does the administration estimate negotiations will take?

Ms. BARSHEFSKY. I think it is difficult to give you an estimate, Mr. Zimmer. When the United States entered free trade negotiations with Israel, an economy even smaller than Chile's, a population much smaller than Chile's, one would have thought this would have been a negotiation that could have been concluded in a matter of months. There was also uniform political support for the negotiation.

The negotiation of the U.S-Israel agreement, which was all of about 16 pages long in contrast to the NAFTA, took well over a year to conclude. It is very difficult to put a timeframe on these negotiations. Obviously, we and Chile, Canada and Mexico would like to proceed as quickly as possible, and obviously fast track will play a role in this.

Let me say, though, that there are a number of issues we will have to address with respect to Chile. You are right that Chile does have generally an open economy, but it does retain an 11-percent static tariff across the board that is four times the average U.S. tariff.

There are sanitary and phytosanitary issues that arise, intellectual property rights issues that arise, there are issues with respect to potential subsidy practices by the Chilean Government, there are also issues with respect to their procurement regime, their financial services regime, investment regime, and market access more generally.

So there is a lot of ground that we will have to cover. We are very optimistic, and there is no question that the Chilean economy at this juncture is far more open than the Mexican economy was when we began NAFTA discussions, but there is still a lot of work to be done.

Mr. ZIMMER. You alluded to fast track. In your opinion, how far can trade negotiations with Chile progress without fast track negotiating authority in place?

Ms. BARSHEFSKY. That is perhaps a question best directed to the Chileans, in the sense that from the U.S. point of view we would wish to go as far as possible to conclude an agreement. But I suspect from the Chilean point of view that there will be great reluctance to enter into sensitive areas, to the extent Chile does not have the confidence that an agreement, once negotiated, will not be renegotiated.

Mr. ZIMMER. Has the lack of fast track negotiating authority hampered the U.S. efforts to achieve a Free Trade Area of the Americas agreement by the year 2005?

Ms. BARSHEFSKY. It has not at this juncture, but we are in the process now of preparing for our Denver trade ministerial, which will be the first ministerial under the Miami Declaration for a Free Trade Area of the Americas by the year 2005. That ministerial is next week. We will be forming working groups and setting out the analytical base for hemispheric-wide negotiations on very short order. Not having fast track will be an impediment to resolutions, but not this year.

Mr. ZIMMER. Are there areas where the USTR can negotiate that do not require fast track authority in order to implement the results?

Ms. BARSHEFSKY. To answer your question most accurately, I would have to go through every area. There are areas in any trade agreement that do not require changes to U.S. laws in any respect and, therefore, arguably that would not require fast track. But overall, as we look at these trade agreements, we see a hefty component on market access which tends to be tariff related issues which must have a statutory mandate and require statutory change.

In addition, as we look at even a rules-based regime, whether it is with regard to procurement or investment or other areas, we often see the need to change or slightly amend U.S. law, and even technical changes will require legislative authority.

Mr. ZIMMER. Thank you.

Ms. BARSHEFSKY. Thank you.

Mr. ZIMMER. Thank you, Mr. Chairman. I yield back.

Chairman CRANE. Mr. Coyne.

Mr. COYNE. No questions, Mr. Chairman.

Chairman CRANE. Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

Ambassador, I wonder if you would respond to some comments that were made by one of the members of the congressional panel earlier that concern me regarding stability of Chile. There was reference made to the current problems between the military and the government, and I wonder if you would take a broad approach to this, for example, letting us know the current state of their economy, their fiscal situation, their savings rate and that sort of thing, because I would like to know in your mind what we are dealing with in terms of stability of this nation.

Ms. BARSHEFSKY. I would be pleased to do that, because I disagree with the comments made this morning. Chile has very substantial market-based economic reforms. It has been the pioneer of a market-based system in Latin America going back 25 years ago. This is not a recent phenomenon with Chile. This goes back many, many years, well ahead of its time.

Chile went through a peso-type crisis of the kind Mexico is going through now in 1982, and from that Chile learned many, many lessons, and let me indicate what those were. First of all, since that time, Chile has moved to a competitive exchange rate policy premised on a basket of currencies. There are many who believe that

had that been the Mexican policy, there would not have been a peso crisis.

Chile coupled that move with impressive management of its central government's budget. We now have in Chile a budget surplus 8 years in the running. I wish the United States were in that position. Chile has an outstanding domestic savings rate far in excess of the United States, an extraordinarily high investment rate, and much of this investment is long-term investment, not short-term speculative investment. Chile's reliance on foreign capital because of these policies has been dramatically reduced, and its monetary policies generally have been designed to dampen inflation, which the Chilean Government has done very, very well.

Chile is the first country in Latin America, including Mexico, to be given an investment grade rating by the international financial community. Its currency is appreciating against the dollar. It has, as I said, a budget surplus. Its financial system is quite strong, very profitable, and Chile is known to have the best banking supervisory regime in Latin America.

So this is an economy that has been on the move for many, many years. This is not a recent phenomenon. What we see because of sound fiscal and monetary management is an economy that the Davos Forum rates as extraordinarily impressive.

Ms. DUNN. Thank you very much.

I want to pick up on a theme that I heard from other members of our panel, and that is the fast track negotiations. How flexible is the administration as to what is going to be included in fast track? We have talked about environmental issues, labor issues, and so forth. I would like to know what the chances are of negotiating fast track, because I believe that predictability will assist us in finally making this deal.

Ms. BARSHEFSKY. Ambassador Kantor testified extensively before the committee on this issue, and as he indicated, and we have spoken with Mr. Crane and others on the committee, the administration seeks to work in a bipartisan fashion with Congress to fashion a fast track that suits all of our purposes.

Trade has long been a bipartisan issue. I believe that there is a greater appreciation throughout the Congress now than ever before at the importance of U.S. leadership with respect to market opening and the importance that the U.S. economic health attaches to global growth and access to foreign markets. Fast track is what helps to assure that that will happen.

It has been our consistent position that the NAFTA is not only the NAFTA, but also is its supplemental agreements on labor and the environment. The Chilean Government has indicated a willingness to enter into the supplemental arrangements, because bear in mind that much of these arrangements have to deal with cooperative efforts among the three countries and coordination among the three countries, which is very, very important on these issues because they are trade related and do impact ultimately the fairness of these trade agreements.

In addition, it has been our consistent position that no administration should have its hands tied with respect to what it can and cannot negotiate when one goes into a negotiation. Circumstances change and economics change. It is critical that any administration

always be in the position to bring home the best, the most comprehensive series of agreements possible, handling whatever the issues may be that arise, whether competition policy, bribery, or any other of these very important trade related issues, as well as trade related environmental and labor issues.

We are also in a position in our own hemisphere where all 34 nations have stressed the importance of labor and environmental issues as we proceed to construct the Free Trade Area of the Americas. It would be ironic if it was the United States that did not recognize the importance of these issues and that did not attempt to work with the hemisphere in a cooperative way to move forward on these issues as a free trade area formed.

So for all of these reasons, we would hope to have strong bipartisan support. We want to work with the subcommittee and Members of Congress to fashion a fast track remedy. There is no question, it is important to U.S. leadership to have this fast track procedural device, and there is also no question that it is equally important for all of us to retain flexibility to ensure that our broad economic interests can be served in these agreements.

Ms. DUNN. Finally, Madam Ambassador, I would like to ask you about one of the comments you made having to do with Chile's interest in MERCOSUR and in dealing with those nations. You said that you believe there could be potential benefits. Are you saying then that that will not be a conflict to Chile's accession to NAFTA?

Ms. BARSHEFSKY. I do not think there will be any conflict because Chile's accession to the NAFTA will depend upon its ability to adhere to NAFTA rules and disciplines. Those will not be changed in any way because Chile is also in discussions with MERCOSUR. But we do think that Chile provides a very important psychological link, if you will, between NAFTA and MERCOSUR potentially, and also that this allows the NAFTA partners and the MERCOSUR partners, and perhaps ourselves, to achieve some linkages between these trade agreements which at the end of the day will be the single most important factor in achieving hemispheric integration.

There is no question that if NAFTA and MERCOSUR cannot get together in some productive way at the end of the day, this hemisphere will not be fully integrated, the rules of trade will not be uniform, market access will not be expanded in the way that it should. So Chile helps provide this kind of early link and we would look forward to ultimately NAFTA and MERCOSUR joint involvement as we move forward with respect to the Free Trade Area of the Americas.

Can I also say, with respect to your fast track questions and also with respect to this last question, that this hemisphere has the most active free trade history of any hemispheric region in the world, and this hemisphere will not wait for the United States as it integrates.

The issue is not will the hemisphere form subregional groupings. There are five major subregional groupings covering virtually all countries in the hemisphere, of which NAFTA is only one. The issue is will the rules of integration be direct and influenced heavily by the United States. It is critical that those rules be influenced heavily by the United States. It is critical that we exert leadership

to ensure the levelest playingfield for our exporters and for our economic growth.

Ms. DUNN. Thank you. I yield back.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Thank you very much, Madam Ambassador, and all the staff of the USTR for the good work that you do not only on this issue, but many others.

You mentioned in your testimony that Chile was the bridge between the United States and South America and that this gave us an opportunity to help ensure that that bridge was a good one, and I think that is exactly right. I think we cannot help but be impressed by what has gone on in Chile in terms of the economic and societal successes in that country.

You talked about the process and the fact that next month the USTR will lead an interagency task force or a negotiating team that will begin negotiating the accession of Chile to the NAFTA. I want to add my voice to others who have said that intellectual property rights certainly should be at the very top of the list of the issues that need attention in that negotiation.

You also, I think, recited a whole list of issues to Representative Zimmer as you spoke to him, all of which are important. One which I did not hear was the foreign direct investment, the impediments that now exist to foreign direct investment such as the 1-year limitation on capital repatriation, and certainly that is another issue that will need attention.

I think, though, with the team that has been put together or is being put together to negotiate, the experience of the team, that this is an opportunity to not only conclude successfully Chilean accession, but it well could be the model for future accessions to the NAFTA, and I think this is an opportunity for us to certainly get it right and to help ourselves in the future.

I had one specific issue having to do with NAFTA which may have some implications as it relates to Chile's accession that I would like to inquire about. For the past 2 years, the U.S. tire producers have been seeking the elimination of some unfair trade barriers that exist to U.S. made tires. Since the implementation of NAFTA, there have been requirements that are at odds with NAFTA, at odds with the requirements that existed before NAFTA in Mexico, and these are things like unreasonable labeling and certification requirements.

I know you and USTR have been working on this issue and you are aware of how much the industry has done to try to enter the Mexican tire market. My question is, if you could just give us a brief update on where this currently stands, and particularly what did we learn from this and other processes like this that may have some implications as it relates to Chile's accession to the NAFTA.

Ms. BARSHEFSKY. Let me answer the second part of your question first. The answer to the second part of the question—and I think this was a sentiment expressed perhaps by Mr. Thomas and others—is you have to get it right the first time. It is very hard, if you do not have it right the first time, to go back and to fix what was not fixed the first time.

For that reason, we have undertaken with respect to the Chilean accession an extraordinary amount of preparatory work relative to the size of the economy to attempt to get it right the first time, to avoid some of the problems that we have had with respect to the NAFTA.

You will recall that when we took office, when this administration took office, the NAFTA was already concluded. It had already been signed. While we had attempted in some areas to reopen the agreement, we were unable to do that because there had already been presidential signoff before Mr. Clinton took office. What we hope to be able to do is not repeat that situation as we look toward Chilean accession and as we look toward the creation of the Free Trade Area of the Americas.

With respect to the tire issue, you are right, we have been working on this issue for some time now. We have talked to members of our domestic industry about this to try and formulate an effective strategy. There are two principal problems. The first has to do with the Mexican requirements that tire labeling be in Spanish. No country in the world requires this. The standard is English, not Spanish.

I have potentially a little bit of good news to report on that, which is that we understand that Mexico will put out for public comment the ability to label tires in Spanish, not by changing the molds of the tires, which is a problem for our industry, but by affixing a label, a gummed label to the tires which would be acceptable to our industry. We are trying to determine now when will this proposed rule change be published, how much time will be open for comment, and so on and so forth. But we may be seeing some movement there.

The second issue in which we have not seen any movement yet has to do with third-party certification requirements in terms of safety standards and so on. In the United States, companies self-certify conformity with U.S. regulations, and this is a common practice in other markets. But in Mexico, certification is complicated by the fact that Mexican law requires these certifications be conducted by a Mexican testing laboratory, and the Mexican laboratory that is accredited to test is currently controlled by competitive manufacturers of tires. Well, this is an unacceptable situation.

We have made several proposals to the Mexicans on this issue which we coordinated with our industry. We have asked for responses in writing from the Mexican Government. We have yet to receive written responses. But we are pursuing that and then we will be working with the industry, and we will be pleased to work with you on what our next steps are.

Mr. PAYNE. Thank you very much.

Thank you, Mr. Chairman.

Chairman CRANE. Thank you, Ambassador Barshefsky. We look forward to working with you and Ambassador Kantor as we consummate the negotiations with Chile to bring them into the free trade agreement.

Ms. BARSHEFSKY. Thank you, Mr. Chairman.

Chairman CRANE. With that, the subcommittee will stand in recess until 2 p.m.

[Whereupon, at 11:55 a.m., the subcommittee recessed, to reconvene at 2 p.m., the same day.]

Chairman CRANE. The subcommittee, I am sad to say, is reconvening very belatedly and we do not, in the subcommittee, control the action on the floor, but I understand Mr. Liebenow has to leave in about 5 minutes. So we will proceed with you, first, Mr. Liebenow, and I understand that you have a plane connection and so you have to depart the subcommittee. But you may proceed.

STATEMENT OF LARRY A. LIEBENOW, PRESIDENT, QUAKER FABRIC CORP., ON BEHALF OF THE U.S. CHAMBER OF COMMERCE, AND THE ASSOCIATION OF AMERICAN CHAMBERS OF COMMERCE IN LATIN AMERICA

Mr. LIEBENOW. Thank you, Mr. Chairman. Actually, that is very kind. I did manage to change the flight to slightly later on, so I will be here a little bit longer.

Mr. Chairman, and the other members of the subcommittee, I am Larry Liebenow, president of Quaker Fabric Corp., Fall River, Mass. Quaker is a publicly owned textile manufacturer specializing in upholstery fabrics for the United States as well as international markets. With nearly 1,800 employees, Quaker Fabric has been able to double its sales since 1990, in great part due to its development of export markets, especially in Mexico and Latin America.

I am pleased to present this testimony in support of Chile's accession to the North American Free Trade Agreement on behalf of both the U.S. Chamber of Commerce where I serve as chairman of the Western Hemisphere Task Force, as well as on behalf of the AACCLA, Association of the American Chambers of Commerce in Latin America.

Both the U.S. Chamber of Commerce and AACCLA strongly support Chile's rapid accession to the core commercial principles in the NAFTA. In the fall of 1992, the chambers' board of directors called for both congressional approval of the completed NAFTA and expansion of free trade to the entire hemisphere.

This commitment was reaffirmed last year when the creation of a Free Trade Area of the Americas beginning with Chile's prompt accession to the NAFTA was voted a priority issue by the U.S. Chambers membership.

Therefore, we are pleased that U.S. Trade Representative Michael Kantor has initiated negotiations with Chile, and we urge the administration and this Congress to bring these negotiations to a swift and successful conclusion.

Chile is one of the most dynamic South American markets for U.S. exports and most widely acknowledged model for economic reform for emerging markets around the world.

NAFTA has been a winning proposition for the three original partners. It has provided stability to Mexico in a time of crisis and opened new markets for American, Canadian, and Mexican firms. Expansion of this agreement to the rest of the hemisphere would grant U.S. firms seeking opportunities in Latin America new access to a rapidly expanding marketplace that likes to buy American goods and services.

Furthermore, Chile's accession would recognize that nation's commitment to free market economics, sending a signal of affirma-

tion to the rest of the hemisphere. It would also help U.S. exporters knock down remaining barriers to the Chilean market.

By further opening the Chilean market, the United States can solidify its position as Chile's leading trading partner. Between 1987 and 1993, U.S. exports to Chile grew more than 200 percent due to unilateral market opening moves by the Chilean Government. The negotiation and accession agreement would lock in access to the Chilean market. This, in turn, would help maintain the steady rise in U.S. exports and create jobs here at home.

Expanding NAFTA to Chile is also an important step toward creating a Western Hemisphere in which duties, subsidies, and nontariff barriers are eliminated and goods and services flow freely. Wealth and jobs will be created while also making participating nations more competitive in the global economy.

Indeed, adding Chile to the NAFTA is needed to ensure that the eventual Free Trade Area of the Americas is based on the highest possible standards. For example, in the area of telecommunications services, Chile currently offers the most open and competitive environment in the region, even allowing full access to its basic telecom or its domestic long-distance market.

As part of the move toward market economies in the region, countries are not only acceding to the GATT/WTO but also initiating ambitious free trade negotiations with their neighbors. Including the NAFTA, over 23 recent bilateral and regional trade agreements have been negotiated among the nations in this hemisphere.

Chile has negotiated deals with Mexico, Colombia, and Venezuela; association negotiations with MERCOSUR, the common market comprised of Argentina, Brazil, Paraguay, and Uruguay, are currently under way.

Recognizing the move toward free trade across the globe, the 34 democratically elected leaders of this hemisphere who gathered for the December Summit of the Americas agreed to form a Free Trade Area of the Americas by the year 2005. In preparation for this historic gathering, the U.S. Chamber of Commerce, AACCLA, and the Council of the Americas summarized the views of the private sector in this hemisphere in our Agenda for the Americas white paper. This document called for a hemisphere-wide agreement based on the core commercial principles of the NAFTA as a minimum for future obligations. We were pleased that the hemisphere's leaders chose to incorporate many of our recommendations into the summit's declaration.

In order to further the process of hemispheric integration and anticipation, the first post-Summit of the Americas meeting of the hemisphere's trade ministers scheduled for later this month in Denver, the same three organizations mentioned above collaborated to compile a list of next-step recommendations to guide the ministers which I have attached to my written statement.

Mr. Chairman, we believe that Chile's accession is a crucial first step toward advancing the Summit of the Americas commitment. This point cannot be emphasized enough—we must move quickly with Chile as a first step toward expanding NAFTA across the region.

While the United States is surely the market to which the entire world seeks preferential access, no one should falsely assume that

the rest of the hemisphere will put integration on hold until the United States is ready to move forward.

If we fail to engage the rest of the region, we will risk ending up with a fragmented patchwork of trade rules across the hemisphere which could limit access to those markets for U.S. business.

The experience of my own company, a mid-sized New England textile mill, is representative of what opening trade in the hemisphere can mean. Quaker Fabric is committed to maintaining its high rate of growth and providing additional employment in southeastern Massachusetts. It is clear to us that this objective can only be achieved by embracing opportunities to sell our products around the world.

Now we are making that effort in our product development, sales, and distribution systems and by making the necessary investments in our manufacturing facilities. We have demonstrated we can do it, because while we have been doubling sales, we have also increased exports to 20 percent of our total sales from virtually nothing 5 years ago.

All we ask from our government is its help in eliminating market barriers to our products and, in particular, the markets of Latin America.

We do not, however, want to see our government link the reduction of trade barriers to other noncommercial issues. The United States has rightly sought to cooperate with other countries in promoting respect for worker rights and strengthening environmental protection.

However, both AACCLA and the U.S. Chamber of Commerce steadfastly oppose the use of trade negotiations and trade sanctions to achieve international labor and environmental objectives. We believe that this approach could become a nontariff barrier to trade within North America, particularly with respect to Chile or other nations in this hemisphere with whom we do not share a common border, as we do with Canada and Mexico.

Therefore, we strongly recommend that any labor or environmental discussions with Chile be conducted on a separate track. Any eventual agreements between our nations in these areas must not contemplate the use of trade sanctions for their enforcement. So while we strongly support the approval of broad, fast track authority for the President, this authority should be limited to commerce.

We would be forced to oppose any formulation of fast track negotiations authority that contains linkage between trade, labor, and environment as we did last summer.

Mr. Chairman, the U.S. Chamber of Commerce and the Association of the American Chambers of Commerce in Latin America appreciate the opportunity to share our views on this important objective. We look forward to working with the Ways and Means Committee, the Congress, and the administration to quickly negotiate and implement an agreement to add Chile to the NAFTA.

I will be happy to answer any questions that you may have. Thank you.

[The prepared statement and attachment follow:]

STATEMENT OF LARRY A. LIEBENOW
PRESIDENT, QUAKER FABRIC CORP.
ON BEHALF OF THE U.S. CHAMBER OF COMMERCE
AND THE
ASSOCIATION OF AMERICAN CHAMBERS OF COMMERCE
IN LATIN AMERICA

June 21, 1995

Mr. Chairman and members of the subcommittee, I am Larry Liebenow, President of Quaker Fabric Corporation in Fall River, Massachusetts. Quaker Fabric is a publicly owned fabric manufacturer specializing in upholstery fabrics for the United States as well as international markets. With nearly 1,800 employees, Quaker Fabric has been able to double its sales since 1990, in great part due to its development of export markets, especially in Mexico and Latin America.

I am pleased to present this testimony in support of Chile's accession to the North American Free Trade Agreement (NAFTA) on behalf of both the U.S. Chamber of Commerce, where I serve as Chairman of the Western Hemisphere Task Force, as well as on behalf of the Association of American Chambers of Commerce in Latin America.

The U.S. Chamber of Commerce is the world's largest voluntary business federation, representing 215,000 businesses, 3,000 local and state chambers of commerce, 1,200 trade and professional associations, and 72 American Chambers of Commerce abroad. The Association of American Chambers of Commerce in Latin America (AACCLA) represents the 22 American Chambers of Commerce in Latin America and the Caribbean. AACCLA's member AmChams represent over 16,500 corporations active in the region, making the association the leading voice for American business operating in the region.

Both the U.S. Chamber of Commerce and AACCLA strongly support Chile's rapid accession to the core commercial principles of the NAFTA. The U.S. Chamber's support for negotiations with Chile dates back to the fall of 1992, when our Board of Directors called for both Congressional approval of the completed NAFTA and expansion of free trade to the entire hemisphere. More recently, creation of a Free Trade Area of the Americas, beginning with Chile's prompt accession to the NAFTA, was voted a priority issue by the U.S. Chamber's membership for the 1995-1996 National Business Agenda.

We are pleased that United States Trade Representative Ambassador Michael Kantor initiated formal negotiations with Chile on June 7, 1995. We urge the Administration and this Congress to closely collaborate to ensure that these negotiations are brought to a swift and successful conclusion.

NAFTA ACCESSION AND CHILE

Chile is one of the most dynamic South American markets for U.S. exports and the most widely acknowledged model of economic reform for emerging markets around the world. NAFTA has been a winning proposition for the three original partners. It has provided stability to Mexico in a time of crisis; it has opened new markets for American, Canadian and Mexican firms looking to expand their market share. Expansion of this agreement to the rest of the Hemisphere would grant companies across the region, especially U.S. firms already seeking opportunities in Latin America, new access to a rapidly expanding marketplace that has historically been predisposed to buy American goods and services.

As a first step toward the creation of a Free Trade Agreement of the Americas, Chile's accession would recognize that nation's commitment to free market economics, while at the same time help U.S. exporters knock down the final barriers in reaching the Chilean market. Elimination of tariffs, improvements in intellectual property rights protection and the elimination of some remaining investment barriers would present substantial new opportunities for American firms of all sizes.

By further opening the Chilean market, the United States can solidify its position as Chile's leading trading partner. Between 1987 and 1993, U.S. exports to Chile grew more than 200%, largely due to unilateral moves by the Chilean government to open its economy. Now, the negotiation of an accession agreement would lock into place access to the Chilean market, thus helping to maintain the steady rise in U.S. exports, which creates jobs here at home.

NAFTA's disciplines cover all aspects of trade and investment, from agriculture to standards to national treatment. Expanding NAFTA to Chile is an important step toward creating a Western Hemisphere in which duties, subsidies and non-tariff barriers are eliminated, and goods and services flow freely from one nation to another. By creating such an environment, wealth and jobs will be created across the region, while also making participating nations more competitive in the global economy.

Chile is Latin America's most open economy. By "locking in" Chile's favorable rules in a trade agreement, we will be paving the way for future free trade agreements benchmarked on NAFTA's already high standards. Indeed, adding Chile to the NAFTA is the single concrete step needed to ensure that an eventual Free Trade Area of the Americas is based on the highest possible standards. For example, in the area of telecommunications services, Chile currently offers the most open and competitive environment in the region, even allowing full access to its basic telecom (domestic long distance) market.

EXPANDING NAFTA TO THE REST OF THE HEMISPHERE

Over the last decade, nation after nation within Latin America has implemented market-based economic reforms that have opened once virtually closed economies to U.S. goods and services providers of all sizes.

As a result, the potential for expanded U.S. trade and investment throughout the Western Hemisphere is enormous, despite the short-term effects of the Mexican peso crisis on currency and financial markets. By 1994, trade between the United States and Latin America exceeded $125 billion and had grown 46% over the previous four years. The 340 million consumers and $1.3 trillion GDP of the Latin American region offer enormous opportunities for U.S. exports of goods and services. In gauging this potential, the Department of Commerce has estimated that by 2010, U.S. exports to Latin America will exceed our exports to Europe and Japan combined.

As part of this move toward market economies, countries in the region have realized the benefits of fair and open trade by acceding to the GATT/WTO and initiating negotiations to reduce trade barriers with their neighbors in order to spur economic growth. Including the NAFTA, over 23 recent bilateral and regional trade agreements have been negotiated among the nations in this hemisphere. Chile has been no exception; to date, it has negotiated deals with Mexico, Colombia, and Venezuela, while association negotiations with Mercosur (the common market comprised of Argentina, Brazil, Paraguay and Uruguay) are currently underway.

The nations of Latin America strongly supported President Bush's call in 1991 for a free trade zone stretching from Alaska to Argentina. Nearly every nation in the region strongly supported the North American Free Trade Agreement, which they view as the first step toward eliminating trade barriers across the entire hemisphere.

At last December's Summit of the Americas, the 34 democratically elected leaders of this hemisphere built on the successful implementation of NAFTA and the WTO by agreeing to form a Free Trade Area of the Americas by 2005. Furthermore, they agreed to make substantial progress toward this goal by the year 2000. While this is admittedly an ambitious

goal, it is certainly not an impossible one. However, in order to accomplish it, the United States cannot afford to hesitate to make concrete progress toward establishing a hemisphere-wide free trade area, as mandated in the Summit Declaration.

Last year, in preparation for the Summit of Americas, our organizations gathered the views of the private sector in this hemisphere to produce the "Agenda for the Americas," co-authored by the U.S. Chamber of Commerce, AACCLA and the Council of the Americas. The document called for a hemisphere-wide agreement based on the core commercial principles of the NAFTA as a minimum for future obligations in each of the 13 areas outlined for free trade negotiations in the Summit of the Americas declaration.

We were pleased that the hemisphere's leaders chose to incorporate many of our recommendations into the Summit's declaration. We were especially pleased that they agreed to "maximize market openness through high levels of discipline" in 13 areas, all of which are the basic disciplines included in the NAFTA agreement: tariff and non-tariff barriers affecting trade in goods and services; investment; intellectual property; dispute resolution; agriculture; subsidies; technical barriers to trade (standards); rules of origin; safeguards; anti-dumping and countervailing duties; sanitary and phytosanitary standards and procedures; dispute resolution and competition policy.

In order to further contribute to the process of hemispheric integration and in anticipation of the first post-Summit of the Americas meeting of the Hemisphere's Trade Ministers scheduled June 29-30 in Denver, Colorado, the same three organizations mentioned above collaborated to compile a list of "next step" recommendations to guide the ministers. I have attached these most recent recommendations to this testimony so that they can also provide guidance to this subcommittee.

Mr. Chairman, we believe that Chile's accession is a crucial first step toward advancing the Summit of the Americas commitment. By adding a fourth partner to NAFTA, we can send a signal of our willingness to create a Hemisphere where goods, services, and investments flow without unnecessary impediments. This point cannot be emphasized enough--we must move quickly with Chile as a first step toward expanding NAFTA across the region and sustaining momentum for free trade in the region.

In order to avoid being left behind as the rest of the region seeks to integrate, the United States must move in a swift and decisive manner. While the United States is, without a doubt, the market to which the entire world seeks preferential access, no one should falsely assume that the rest of the hemisphere will put integration "on hold" until the United States is ready to move forward. If we fail to engage the rest of the region in a plan to implement the Summit of the Americas declaration, we will risk ending up with a fragmented patchwork of trade rules across the Hemisphere, which could make NAFTA expansion even more difficult and limit access to those markets for U.S. businesses.

CHILE ENJOYS BROAD-BASED SUPPORT

Chile's NAFTA accession negotiations -- and the subsequent approval by the U.S. Congress -- need not be a contentious or lengthy process. Chile's relatively open economy leaves few obstacles for United States negotiators. Chile's progress in becoming an internationally competitive economy is often held up as a model for development and growth across the political spectrum in the United States.

For all of the above reasons, we urge the U.S. government to quickly move forward to initiate and complete negotiations for Chile's accession to the NAFTA.

QUAKER FABRIC AND LATIN AMERICA

The experience of my own company, a mid-sized New England textile mill, is representative of what opening trade in the hemisphere can mean. Quaker Fabric is committed to maintaining its high rate of growth and providing additional employment in Southeastern Massachusetts. It is clear to us that this objective can only be achieved by embracing those opportunities that exist to sell our products around the world. We are making that effort in our product development, sales and distribution systems, and by making

the necessary investments in our manufacturing facilities. We have demonstrated that we can do it because, as we have doubled total sales, we have also increased exports as a percentage of total sales to 20 percent in 1994 from virtually nothing five years ago. All we ask from our government is its help in eliminating market barriers to our products and, in particular, the markets of Latin America. Your help, in turn, will enable us to continue growing and providing additional employment in a region of our country which very much needs it.

THE NAFTA SIDE AGREEMENTS

The United States has rightly sought to cooperate with other countries in promoting respect for worker rights and strengthening environmental protection. However, both AACCLA and the U.S. Chamber of Commerce steadfastly oppose the use of trade negotiations and trade sanctions to achieve international labor and environmental objectives. Although the final NAFTA side agreements were an improvement over the original Clinton Administration proposals, we continue to believe that this approach could become a non-tariff barrier to trade within North America. We especially question the wisdom of extending this approach to Chile or other nations in the hemisphere with whom we do not share a common border, as we do with Canada and Mexico.

Making trade cooperation contingent upon reaching agreement on complex labor and environmental issues would create a climate of uncertainty for business and would delay or otherwise jeopardize our ability to achieve vital market-opening agreements with other nations. Furthermore, linking labor and environment to trade makes it more difficult and more time-consuming to achieve labor or environmental cooperation than would be possible through separate negotiations.

We therefore recommend that any labor or environmental discussions with Chile be conducted on a separate track and that any eventual agreements between our nations in these areas not contemplate the use of trade sanctions for their enforcement.

FAST TRACK

Fast-track authority is essential if the United States is to pursue international trade agreements. It was critical to the implementation of the NAFTA and the GATT Uruguay Round Agreement. And it will be critical to the successful conclusion of our negotiations with Chile. While we strongly support the approval of broad fast track authority for the President, this authority should be limited to commerce and not also require the resolution of non-commercial issues. As we did last summer, we would be forced to oppose any formulation of fast track negotiation authority that contains such linkages.

CONCLUSION

Mr. Chairman, we appreciate the opportunity to share the views of the U.S. Chamber of Commerce and the Association of American Chambers of Commerce in Latin America on this important objective. We look forward to working with this Subcommittee, the Congress and the Administration to quickly negotiate and implement an agreement to add Chile to the NAFTA. I look forward to the opportunity to answer any questions.

Attachment

Private Sector Recommendations for the First Summit of the Americas Trade Ministerial June 29-30, 1995 Denver, Colorado

In the first milestone meeting following the historic Summit of the Americas, the Trade Ministers of 34 countries of the Western Hemisphere will meet in Denver, Colorado, on June 29-30. The ministers are charged with setting a course to achieve the Summit's stated goal of a Free Trade Area in the Americas. The Denver meeting should assess progress and establish interim goals and deadlines through the end of the millennium.

In preparation for the Summit of the Americas, the Chamber of Commerce of the United States of America, the Association of American Chambers of Commerce in Latin America (AACCLA), and the Council of the Americas issued an *Agenda for the Americas*, which enumerated a series of private sector goals and priorities for liberalizing trade and investment in the Americas. This effort made a useful contribution to the discussions and decisions of the hemisphere's political leadership at the Summit.

On the occasion of the annual meetings of the Council of the Americas and the Association of American Chambers of Commerce in Latin America in Washington, D.C., May 22-25, 1995, and specifically in regard to the Denver Trade Ministerial, these same three American business associations recommend that the ministers:

- Reaffirm the essential goal of establishing a Free Trade Agreement of the Americas (FTAA) no later than 2005, to be substantially accomplished by 2000, starting with Chile's accession to the NAFTA by 1996.

- Agree that the FTAA will be based on the most rigorous levels of trade discipline existent in the hemisphere, as detailed in the *Action Plan of the Summit Declaration*, specifically in regard to: elimination of tariff and non-tariff barriers, services, agricultural products, intellectual property rights, government procurement, subsidies, investment, safeguards, rules of origin, and dispute resolution mechanisms.

- Establish specific mechanisms for ongoing private sector participation in the post-Summit efforts to create the FTAA.

- Affirm that in seeking the reconciliation of the some 23 subregional and bilateral trade agreements now in place, governments must strive for the highest standards of discipline and liberty, and that a process and timetable be established to accomplish that goal.

- Affirm, as a complement to trade liberalization, a continuing commitment to the liberalization of private investment regimes, including: accelerated privatization of government-owned enterprises; equal treatment of both foreign and domestic investors; and the opening up to private investment of sectors, which in some countries are currently reserved for government or national ownership, such as energy and telecommunications.

- Agree to standardize and simplify customs procedures and to harmonize government standards, testing, and certification requirements.

- Affirm the importance of judicial and regulatory reform and the establishment of systems which assure transparency and advance notice to the maximum extent possible in respect of all trade, financial and investment measures by governments.

- Ensure that appropriate legislative procedures exist in each country to permit the timely approval of an FTAA as negotiated.

We take the opportunity of the upcoming Trade Ministerial to declare our strong support for this process, and to commend the governments of the Americas for initiating and participating in this worthwhile effort. Democratic government, private enterprise and free trade comprise the basis for freedom and prosperity. We welcome the opportunity to participate in the Summit's efforts to enlarge these areas of human endeavor.

Chairman CRANE. Thank you, Mr. Liebenow, and now Ms. Urzuá and I want to thank you so much for the inconveniences you have suffered because you flew, I understand, all the way up from Santiago for our hearing, and we are grateful to have you here.

STATEMENT OF BARBARA URZUÁ, EXECUTIVE VICE PRESIDENT, FREE TRADE AGREEMENT OFFICE, AMERICAN CHAMBER OF COMMERCE IN CHILE

Ms. URZUÁ. Thank you, Mr. Chairman.

I thank you for the opportunity to testify. I am here today in representation of the AmCham-Chile, American Chamber of Commerce in Chile. We represent 1,350 members from both U.S.-owned companies doing business in Chile, and Chilean businesses that either trade with the United States or represent a U.S. company in the Chilean territory.

For the American business community, securing markets in Latin America is a priority. More so if we look at the tremendous increases that U.S. exports have experienced in the region. From 1985 to 1994, exports to Latin America and the Caribbean more than doubled, a growth rate three times that of total U.S. exports. By the end of 1995 it is expected that U.S. exports will reach close to $100 billion.

First, I would like to focus on what are the benefits for the United States from Chile's accession to NAFTA. Chile is the economic model among developing countries. Its accession to NAFTA will give concrete and permanent backing to Chile's democratic system and free market economy. The U.S. recognition to Chile is important for the U.S. policy in Latin America.

Many U.S. companies successfully do business in Chile and would like to expand their success story to other Latin America countries that have yet to undertake the needed economic reforms. Chile's accession to NAFTA is a clear signal to those countries that economic reforms must be in place in order for them to become accepted into NAFTA or the Free Trade Area of the Americas.

In tariff reductions, alone, U.S. exporters to Chile would benefit by approximately $260 million annually. Total U.S. exports to Chile in 5 years could grow to $3.5 billion annually. AmCham-Chile is convinced that Chile's accession to NAFTA would give additional impetus to the growing Chilean economy and would contribute to additional growth in U.S. exports of goods and services.

In support of this conclusion, our member companies in the past have shown in polls that over 80 percent believe that their company would benefit from Chile entering a free trade agreement with the United States.

I would like to provide you with some quotes from some of the U.S. multinationals doing business in Chile. The first is General Motors. They say, "We strongly support Chile's accession to NAFTA. Accession to NAFTA by Chile would provide American companies preferential access to this dynamic and rapidly growing market. Importantly, Chile's accession to NAFTA would provide a southern anchor to the agreement, facilitating progress toward hemisphere-wide free trade agreement."

Marco Chileana, this is a Seattle-based company, they say, "We export technology, know-how, and materials from the United States

into Chile. More recently we have diversified into mining, lumber and pulp, transport, and steel. From a purely commercial standpoint, Chile's access to NAFTA will make U.S. goods and services more competitive in this market."

We have similar quotes from others such as Citibank, American Airlines, Phelps Dodge, Exxon, and Procter & Gamble.

More broadly, Chile's accession to NAFTA will demonstrate the U.S. commitment to expanding world trade. Coming on the heels of NAFTA, it clears a way for region-wide agreements and reveals to other countries in the hemisphere the soundness of a hemisphere-wide trading system.

On Chilean economic performance, in 1994 Chile completed more than 12 years of continued and strong growth. Between 1990 and 1993, Chile's growth rate averaged 7 percent, while the world economy grew only at 1.8 percent. The strong growth performance of Chile has been the result of high savings and investment rates and fast productivity growth. Chile's investment rate is the highest in the region.

Most capital inflows have been used to finance investment. Since 1990, the stock of foreign direct investment has doubled. Macroeconomic policy has contributed to the achievement of fast and sustainable growth. Chile has run budget surpluses since 1990 and for most of the last 20 years. In 1994, public savings, current incomes minus current spending, reached 4.9 percent of GDP.

Monetary policy, in turn, managed by an independent central bank, has been geared to achieve price stability. Chile's financial system is strong and has low levels of risk. Standard and Poor's has described Chile's banking supervisory bureau as the best in Latin America. Chilean banks have strong balance sheets and in the last 10 years profitability has averaged 19 percent.

Chile has maintained an open trade and investment regime with other countries for many years. Since 1976, it has applied a uniform tariff system to imports, excluding certain automobiles and a few products in the agricultural area. Since 1991, the general tariff rate stands at 11 percent. All products domestically produced or imported are subject to an 18-percent value-added tax.

Chile has signed bilateral trade agreements with Mexico and Argentina in 1991, with Bolivia, Venezuela, and Colombia in 1993, and is currently negotiating one with Peru. Chile has also deepened its relations with the Asian nations. In November 1993, Chile was accepted as a member of APEC.

Chile welcomes foreign investment. Chile has developed a transparent investment policy that benefits the domestic and foreign private sectors participation alike. Generally Chile offers no subsidies, concessions, or other incentives to attract investment. An exception to this rule has been the law 701 of 1976 that promotes forestry development by returning 75 percent of the planting expenses to investors. This incentive, however, is available to both local and foreign investors.

The DL 600 has set a standard in Latin America, becoming a model for many countries in the area. The law offers a nondiscriminatory treatment, a simple registration procedure, transparent rules, open access to markets and sectors, and liberal profits and capital remittance rules. The distinctive feature of the law is a

signing of a contract in which the investor and the Chilean Government agree on obligations and rights for both parties.

I see that my time is almost up so I will go into my conclusion. Chile is a leader in Latin America in terms of market-based reforms, its transition to democracy, its present economic indicators, and its continuous growth.

Because of its leadership role, Chile has been regarded by not only its neighbors in the Western Hemisphere, but also by other countries as a model for economic development.

Chile's accession to NAFTA will benefit Chile and the NAFTA member countries. It is an important step toward the larger goal of a free trade zone encompassing the Western Hemisphere. This holds great promise for the United States generally and for the expansion of U.S. exports.

Admitting Chile promptly will send a signal to the rest of the region that sound economic policies and a strong democracy—lowering inflation, eliminating public debt, and subsidies, privatizing state-owned industries and cutting tariffs—will be recognized through closer economic ties with North America. If Chile cannot qualify for NAFTA membership, no nation can.

In order for the administration to successfully conclude Chile's accession to NAFTA, fast track negotiating authority must be granted. Failure to approve fast track authority this year will set back Chile's accession to NAFTA until 1997, losing 2 more years notwithstanding the firm commitments made by both Presidents Bush and Clinton.

We ask for your support, as well as your assistance in persuading other Members of Congress to appreciate the importance of fast track in order to conclude Chile's accession to NAFTA this year.

Mr. Chairman, thank you, very much.

[The prepared statement and attachments follow:]

STATEMENT OF BARBARA URZUA ON ACCESSION OF CHILE TO THE NORTH AMERICAN FREE TRADE AGREEMENT

Mr. Chairman, thank you for the opportunity to testify on what we, the American Chamber of Commerce in Chile, consider to be one of the most important steps towards establishing a hemispheric trade agreement by the year 2005.
Chile's accession to NAFTA, is without doubt an important step towards this ambitious goal which was set forth by the 34 Heads of State of the Americas in Miami last December.

I am here today on behalf of AMCHAM-CHILE,
The American Chamber of Commerce in Chile, a 76 year old entity that currently consists of 515 corporate members and 1350 individual members. Our members are both U.S. owned companies doing business in Chile, and Chilean businesses that either trade with the U.S. or represent a U.S. company in the Chilean territory. Our members represent 85% of the U.S. investment in Chile. The chamber is therefore uniquely situated to provide you with a description of actual experiences of U.S. businesses operating in Chile.

For the American business community, securing markets in Latin America is a priority, more so if we look at the tremendous increases U.S. exports have experienced in the region. From 1988 to 1994, exports to Latin America and the Caribbean more than doubled, a growth rate three times that of total U.S. exports. By the end of 1995 it is expected that U.S. exports will reach close to US$ 100 billion.

The U.S. Chamber of Commerce in its "National Business Agenda 95-96" stated: "The opening of markets around the world is crucial to U.S. firms seeking to grow. Latin America is one of the fastest growing markets...The U.S. Department of Commerce projects that by the year 2010, U.S. exports to the region will exceed our exports to Europe and Japan combined."

I. THE BENEFITS TO THE UNITED STATES FROM CHILE'S ACCESSION TO NAFTA

Chile is an economic model among developing countries. Its accession to NAFTA will give concrete and permanent backing for Chile's democratic system and free market economy. The United States' recognition of Chile's economic accomplishments is an important reinforcement for U.S. policy objectives throughout Latin America.

Many U.S. companies successfully doing business in Chile would like to expand their Chilean success story to other Latin American countries that have yet to undertake the needed economic reforms. Chile's accession to NAFTA is a clear signal to those countries that economic reforms must be in place in order for them to become accepted into NAFTA OR THE FREE TRADE AREA OF THE AMERICAS.

In tariff reductions alone, U.S. exporters to Chile would benefit by approximately US$ 260 million annually. Total U.S. exports to Chile in 5 years could reach 3.5 billion dollars per year.

Amcham-Chile is convinced that Chile's accession to NAFTA would give additional impetus to the growing Chilean economy and would contribute to additional growth in U.S. exports of goods and services. In support of this conclusion over 80% of our member companies in the past have shown in polls that their company would benefit from Chile's entering a free trade agreement with the U.S.

Chile's accession to Nafta provides a unique opportunity for the United States to set a high level of standards for future countries that will follow in this trade integration process. Also, it "locks in" significant reforms that have been made and which open access for U.S. companies in Chile.

More broadly, Chile's accession to NAFTA would demonstrate the United States' commitment to expanding world trade. Coming on the heels of NAFTA, it clears the way for region-wide agreements and reveals to other countries in the hemisphere the soundness of a hemisphere-wide trading system.

II. CHILEAN ECONOMIC PERFORMANCE.-

In 1994 Chile completed more than 12 years of continued and strong growth. Between 1990 and 1993, Chile's growth rate averaged 7%, while the world economy grew at 1.8%.

The strong growth performance of Chile has been the result of high savings and investment rates and fast productivity growth. National savings, as a percent of GDP, reached over 25% both in 1993 and 1994, the highest rate in the world. Investment reached 27% of GDP, the highest in the region. Chile has successfully attracted long term capital investment from around the world and has generated a very sophisticated domestic capital market. The stock of foreign direct investment has doubled since 1990.

Macroeconomic policy has contributed to the achievement of fast and sustainable growth. Chile has run budget surpluses since 1990 and for most of the last 20 years. In 1994, public savings, (current income minus current spending), reached 4.9% of GDP. Monetary policy, in turn managed by an independent Central Bank, has been geared to achieve price stability.

Chile's current reserves equal to more than one year of imports. The massive capital inflows in the 1990's are the result of very good investment opportunities, not the need to finance a growing current account. Policy measures such as the privatization of the national pension system have encouraged domestic investment.

The process of privatization of pension funds started in 1981 and it deserves a very special comment. Each affiliated citizen has his or her own personal account. The funds are administered by private Administration companies. The benefactor elects his or her Administrator company and can transfer from one company to another at any point in time.

Today the fund has accumulated over $ 22 billion dollars, equivalent to approximately 50% of the country's GDP, and has been crucial in the growth of the very sophisticated local capital market. The yield forecasted when the process was initiated was 4% annual return, over inflation. However, the actual yield has been 11% annually.

Chile's financial system is strong and has low levels of risk. Standard and Poors has described Chile's banking supervisory bureau as the best in Latin America. Chilean banks have strong balance sheets, and in the last 10 years profitability has averaged 19%.

III. CHILE'S OPEN TRADE POLICY.-

Chile has maintained an open trade and investment regime with other countries for many years. Since 1976, Chile has applied a uniform tariff system to imports, excluding automobiles and a few products in the agriculture area. All tariffs had been GATT-bound at 35%. Now Chile has reduced its tariff binding down to 25 percent as a result of the recently completed Uruguay Round.

In 1991 the general tariff rate was unilaterally reduced and now stands at 11 percent. All products domestically produced or imported are subject to the 18 percent Value Added Tax (VAT). The VAT applies over the CIF value of the imported goods, plus the 11 percent tariff rate. Capital goods imports can defer duties, interest free, for up to 7 years, when used in export production.

To resolve claims of monopolistic behavior, dumping and other distortions to trade, an Antimonopoly Committee has been established in Chile. In the external front, the trade remedies available to the committee are surcharges, minimum customs values, countervailing duties, antidumping fees and import price bands. Import price bands apply only to wheat, flour, sugar and vegetable oil.

During the past 15 years Chile has actively promoted an economic and trade integration policy to support the development of its export oriented economy. Chile has signed bilateral trade agreements with Mexico and Argentina in 1991, Bolivia, Venezuela and Colombia in 1993 and is currently negotiating one with Peru. (Some of these are more comprehensive than others).

Chile has also deepened its relations with Asian nations. In November 1993, Chile was accepted as a member of the Asia Pacific Economic Cooperation Forum (APEC).

To ease and promote trade relations with other countries, Chile has made specific efforts to improve legislation on intellectual property. The 1991 Industrial Property Law increased the protection of the industrial patents from 10 to 15 years from the date of the grants. However, it did not consider protection for pharmaceutical patents filed before the publication of the law. In 1992 the copyright protection terms was extended to 50 years, up from 30 years. This law also provides for the protection of registered trademarks. Local use of the mark is not required for registration.

IV. CHILE'S WELCOMING FOREIGN INVESTMENT POLICY.-

Chile has developed a transparent investment policy that benefits the domestic and foreign private sector participation alike. Generally, Chile offers no subsidies, concessions or other incentives to attract investments. An exception to this rule, however, has been the law 701 of 1976 that promotes forestry development by returning 75 percent of the planting expenses to investors. This incentive is equally available to both local and foreign investors.

Chile maintains a welcoming attitude towards foreign investors. Two legal bodies support foreign investment in the country, the Foreign Investment Statute Law 600 (DL 600 for short) which has been in effect since 1974, and the regular Chapter 14 of the Central Bank's foreign exchange regulations.

The DL 600 has set a high standard in Latin America, becoming a model for many countries in the area. The law offers a non-discriminatory treatment, a simple registration procedure, transparent rules, open access to markets and sectors, and liberal profits and capital remittance rules. The distinctive feature of the Law is the signing of a contract which the investor and the Chilean government agree on obligations and rights for both parties. Two tax treatments on profits are available to investors: a fixed tax rate or the tax rate applying to local companies, which may be changed. There is an additional tax on remittances.

The DL 600 law has continued to be liberalized. The latest changes were made in 1993 when the repatriation of the invested capital was reduced from a waiting period of 3 years to 1 year. Also, the fixed tax rate alternative on profits was reduced from 49 to 42 percent.

Chile today enjoys the highest foreign investment rate per capita compared to all other Latin American countries.

Chile is not only a recipient of foreign investment. As the economy has grown, Chilean firms have increased their investment in other Latin American countries, especially Argentina and Peru.

V. CHILE'S SOUND MONETARY POLICY.-

The Central Bank develops a monetary policy by targeting real interest and exchange rates. Interest rates are determined by the market. In 1992, the Central Bank set a high interest rate policy to restrain domestic demand growth, at levels compatible with long-term GDP targets.

For years, the Chilean Central Bank has maintained an exchange rate policy oriented to contain short-term fluctuations. Foreign currency may be exchanged in any of the two legal markets: the formal and informal market. Agents involved in trade, credit and investment operations, as well as travellers, have access to the formal market. However, since the gap between the exchange rate determined in these two markets has often been so marginal in the last years, many operations take place in the free access informal markets. Foreign investors have guaranteed access to the formal market.

It is important to note that the reference value of the exchange rate is made up of a basket of currencies, namely, the U.S. dollar, German mark and Japanese yen. The reference exchange rate is adjusted for differences between Chilean inflation and that of its major trading partners.

Despite the Central Bank's efforts to contain short-term fluctuations in the exchange rate, the Chilean peso has and continues to appreciate substantially, becoming a Central Bank ally in its effort to contain inflation, but a problem to exporters. The successful insertion of Chile in the world economy, the sustained increase of foreign investment, and the high interest rate policy, will continue strengthening the chilean peso.

VI. CHILE'S EXPANDING TRADE WITH THE UNITED STATES

U.S. trade with Latin America is important for companies seeking to expand their market share overseas. The U.S. exports as much to Brazil as it does to China and more to Venezuela than to Russia. Also, U.S. exports to Eastern Europe are less than 2% of U.S. exports to Latin America. Today, the U.S. has more trade with Chile than with India.

The U.S. is Chile's major trade partner. During 1994 Chile purchased over 2.3 billion dollars in U.S. merchandise, mostly manufactured goods. Exports from the U.S. to Chile have shown continuous growth. The U.S. is Chile's largest single supplier, providing 23 percent of Chile's imports in 1994. Between 1987 and 1993 alone, there was an increase of 227% in U.S. imports.

This does not take into account the service industry which also continues to grow. In 1994, Chile's major export market was also the U.S., reaching slightly over 2 billion dollars, mostly in raw materials.

Given its liberal trade regime and its continuing economic growth, Chile provides an attractive, growing market for U.S. exports. Chile's need for imported capital goods will continue to grow, particularly for its mining and forestry industries. As the mining sector continues to expand, there has been an increasing demand for mineral refining equipment and other related capital goods.

The development of the Chilean economy will continue to increase the demand for services. With its service-oriented economy, the U.S. is in a strong position to continue its growth in services exported to Chile. In particular, because of the new environmental law passed last year and the increasing concern in Chile for pollution, the demand for pollution-control devices is likely to increase sharply and remain high. This provides U.S. firms with a real potential to sharply increase their exports in this area.

VII. UNITED STATES INVESTMENT IN CHILE

Since 1974, U.S. companies have invested about 5 billion dollars in Chile. U.S. multinationals continue to be a major source of investment in Chile, particularly in mining and more recently in projects to develop the country's abundant forestry resources. Exxon, BHP-Utah, Scott Paper, Phelps Dodge and Citicorp are among the corporations that have invested in Chile's mining and forestry industries in recent years. These U.S. companies are investing in Chile to supplement, not to replace, their U.S. investments.

Future U.S. investments in Chile are likely to continue diversifying as the nation's economy develops and its exports expand. Given Chile's recent success as a "counter-seasonal" exporter of food to the northern hemisphere, there is considerable potential for investment in food packing and processing operations. The Chilean tourism industry is also expected to grow considerably, providing ample opportunities for U.S. investors. In all of these areas, U.S. foreign direct investment will increase U.S. exports to Chile because there is an almost certain "pull through" effect of U.S. exports of goods and services that follow direct investment.

VIII. CHILE'S ENLIGHTENED LABOR AND ENVIRONMENTAL POLICIES

1. LABOR.-

Chile has a widely recognized policy of enlightened labor relations. Workers have well-protected rights to bargain collectively and to strike. Each worker must be provided a written contract, which is strictly regulated by law. In many areas, Chilean law provides greater worker protection than the U.S. law. Under Chilean law, for example, there is paid maternity leave before and after delivery. There is also, severance pay, and procedural safeguards against termination of certain labor contracts.

Most importantly, Chilean workers have shared in the benefits of Chile's increased productivity and prosperity. Chile has for several years enjoyed one of the lowest unemployment rates in the hemisphere, thanks to its economic reforms which has led to a strong economy.

2. ENVIRONMENT.-

On March 1, 1994 Chile passed a general environmental framework law similar in purpose and effect to the U.S. National Environmental Policy Act (NEPA). It establishes an Environmental Impact Assessment process which is applied to significant new investment projects, public and private. It also establishes substantive standards on environmental policy including the "polluter pays" principle, the pollution prevention approach, emissions quality rules, and an orderly phasing-in of these rigorous standards.

Chile has established a number of organizations specifically to handle environmental issues. For example, The National Environment Commission of Chile (CONAMA) was formed in 1990 to coordinate environmental policy and to facilitate dialogue among the business, academic and private sectors.

CONCLUSION

Chile is a leader in Latin America in terms of market-based reforms, its transition to democracy, its present economic indicators, and its continuous growth. Because of its leadership role, Chile has been regarded as a model for economic development, by not only its neighbors in the Western Hemisphere, but also by other countries.

Chile's accession to NAFTA will benefit Chile and the NAFTA member countries. It is an important step towards the larger goal of a free-trade zone encompassing the Western Hemisphere. This holds great promise for the United States generally and for the expansion of U.S. exports.

Admitting Chile promptly will send a signal to the rest of the region that sound economic policies and a strong democracy -- lowering inflation, eliminating public debt, privatizing state-owned industries and cutting tariffs -- will be recognized through closer economic ties with North America. If Chile is not admitted in a timely fashion the United States' commitment to create a Western Hemisphere free-trade agrea will be lost. If Chile cannot qualify for NAFTA membership, no nation can.

In order for the Administration to successfully conclude Chile's accession to NAFTA, fast track negotiating authority must be granted. Failure to approve fast track authority this year will set back Chile's accession to NAFTA until 1997, loosing not only two years but also the current motivation among the countries of the region.

We ask for your support, as well as your assistance in persuading other members of Congress to appreciate the importance of fast track in order to conclude Chile's accession to NAFTA this year.

Mr. Chairman, on behalf of AMCHAM-CHILE, I thank you for this opportunity to share the views of our members with you today.

General Motors Chile S.A.

ARTURO S. ELIAS
MANAGING DIRECTOR

April 20, 1995

Mrs. Bárbara Urzúa
Executive Vice President
Free-Trade Agreement Office
AMCHAM - Chile
Santiago

Dear Bárbara,

The following is in response to your request of April 12.

General Motors Chile, a wholly-owned subsidiary of General Motors Corporation, has been the automotive market leader in Chile for the past 12 years. Our company is the country's largest assembler and importer of automotive vehicles and components. Our sales have grown steadily in the last several years and we envision continued economic growth through the end of the decade.

General Motors Corporation strongly supports Chile's accession to NAFTA. Chile already has one of the most open economies in Latin America. Its commitment to democracy, respect for human and labor rights, and progress on protecting and improving the environment is unmatched in the developing world over the last decade. It also has had the fastest growing economy in Latin America. Accession to NAFTA by Chile will provide American companies preferential access to this dynamic and rapidly growing market. Importantly, Chile's accession to NAFTA will provide a southern anchor to the agreement, facilitating progress towards a hemisphere-wide free trade agreement.

Thank you for the opportunity to provide our inputs.

Sincerely,

Arturo S. Elias

Latin America
Global Finance

CITIBANK

F A X

TO	:	Bárbara Urzúa Executive Vice President Free Trade Agreement Office
FROM	:	Alfonso Peró Citibank N.A.
PAGES	:	2
DATE	:	April 17th., 1995

Dear Ms. Urzúa:

We refer to your fax dated April 12, 1995, related to the process for Chile's accession to the NAFTA.

Citibank is one of the largest and most diversified providers of wholesale financial services in the world, and the only one possessing on a truly global focus, with skills and experience based on a more than 150 years history and a presence in more than 93 countries and territories.

Historically, Citibank has been committed to the emerging economies, always promoting and contributing to the intraregional trade. As the only truly regional bank, we are in a position to provide high-value services to both multinational and local companies through Latin America.

Citibank has been present in Chile since 1916. Next year we will celebrate our 80th anniversary; the banking business has grown in the country and so has Citibank with a range of products and services offered to corporate customers both local and multinational. Therefore, we believe that free trade between the United States of America, Mexico, Canada and Chile will be in the best interest of all of them.

Because we have a great confidence in this country, is our opinion that The Free Trade Agreement will be a vote of confidence in the political and economic model; it will also help to hightened investor confidence and increase market access to Chilean exports.

Alfonso Peró

May 17, 1995

TO : Mrs. Bárbara Urzúa

FROM : S. P. Terni/V. M. McCord

SUBJECT : Exxon's Investments in Chile and the North American Free Trade Agreement

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Exxon Coal & Minerals Company, through its affiliate Cía. Minera Disputada de Las Condes S. A. has operated two large copper mines in Chile as well as ore concentration and smelting facilities since 1978. These facilities employ over 1800 people, produced about 188 k tons of copper in 1994, and represent an investment of over $1 billion. Since acquisition of these operations, Exxon has invested in substantial expansions including a $440 million expansion of the Los Bronces mine in 1992, and a $200 million expansion of the Chagres smelter in 1994. Exxon's investment in Chile has provided the opportunity to introduce American technology and equipment into one of the richest copper ore bodies in the world.

Exxon also has a current investment of over $100 million in Esso Chile Petrolera Ltda., an oil and gas marketing company which has been operating continuously in Chile since 1913.

The democratically elected government of Chile has pursued market-oriented economic policies which have both encouraged foreign investment and led to strong economic growth which provide an example for governments around the world. Exxon's confidence in these policies is demonstrated by our ongoing level of investment in Chile. Exxon would, therefore, like to express its support for the beginning of the process which could lead to Chilean accession to the North American Free Trade Agreement.

Stephen P. Terni
President
Cía. Minera Disputada de Las Condes S.A.

Vincent M. McCord
President
Esso Chile Petrolera Ltda.

ECMC.DOC

AmericanAirlines

Santiago, April 17, 1995

Mrs. Barbara Urzúa
Executive Vice President
Free Trade Agreement Office
Santiago - Chile

Dear Mrs. Urzúa:

We have considered it necessary to write to you in support of your work towards Chile's accession to NAFTA.

Since the begining of American Airlines in Chile, June 1990, we have been able to capture a great slice of the market share pie which has meant capturing sustained profits for our company in Chile and in the United States, increasing the number of jobs in Chile and helping to maintain the jobs in the U.S.. This is thanks to the solid growth experimented by this country over the past 10 to 15 years.

The Chilean market has proven to be very dinamic and since American first started operating in Chile, its growth up to this date has been dramatic. The number of passengers boarded since 1990 for all airlines has grown in a 80.76% up to December 1994, and only for American Airlines the increase is an incredible 262.37%.

We believe that NAFTA will be absolutely beneficiary to the region and to the U.S., bringing even more business to this area and thus more business trips to and from both countries, allowing for even more significant growth and a fair competitiveness among the different airlines.

Sincerely yours,

AMERICAN AIRLINES

Pamela Camus
Country Director for Chile

MARCO CHILENA
Astilleros Marco Chilena Ltda.
Av. Andrés Bello 2113
Clasificador 116
Fonos: 2332363 - 2310906
Fax: 2319865
Santiago Chile

Santiago, April 21st. 1995

Mrs.
Barbara Urzúa
Executive Vice President
FREE TRADE AGREEMENT OFFICE
Zurich 221 Depto. 14
SANTIAGO

Dear Mrs. Urzúa :

Over the last 30 years our company, whose head office is in Seattle, Washington, has been instrumental in the development of Chile's dynamic commercial fisheries sector.

In this regard we export technology, know how, and materials from the United States into Chile. More recently we have diversified into mining, lumber and pulp, transport and steel.

From a purely commercial stand point, Chile's access to Nafta will make U.S. goods and services more competitive in this market, and will allow our company to grow on the strength of U.S. technology.

More objectively, Chile's incorporation into NAFTA will give a strong vote of confidence to Chile's economic model of open markets, strong support for the private sector, non discrimination against foreign investment, and endorsement of competition. This is a model we believe should be followed by other countries in Latin America, and access to NAFTA will give a clear signal that the economic path chosen by Chile will lead to growth, expansion, and a better standard of living for the country's inhabitants.

On the other hand, if the United States turns its back on Chile at this stage of its development, the message not only for Chile, but also for the rest of Latin America, will be badly received, and a great opportunity will be lost.

Sincerely yours,

J. MICHAEL COMBES
General Manager

phelps dodge Mining Company 2600 N. Central Avenue, Phoenix, AZ 85004-3014 • (602) 234-8100

Patrick J. Ryan
Executive Vice President

April 18, 1995

Ms. Barbara Urzúa
Executive Vice President
AMCHAM Chile
Free Trade Agreement Office
Zorich 221 Depto, 14
Las Condes, Santiago
CHILE

Dear Ms. Urzúa:

NAFTA, which took effect January 1, 1994, created a new free trade area that encompasses more than 360 million people and more than $6 trillion in combined domestic output. By breaking down barriers to free trade among the United States, Mexico and Canada, NAFTA is a keystone for the future geopolitical and economic cooperation with our neighbors to the north and south

We should now turn to Chile and its accession to NAFTA. Phelps Dodge has made a strong commitment in Chile to conduct business and to contribute significantly to its economy. We are confident of Chile's economic policies and believe free trade between the United States and Chile is in the best interest of both nations. A true free trade agreement, without side agreements, is imperative as we work to achieve the full benefits of free trade.

Sincerely,

PJR/kat

Oficinas Generales
Av. Portugal 1184
Teléfono: 5569081
Casilla: 3867
Fax: 5551704
Santiago - Chile

Procter&Gamble Chile, Inc.-Agencia

Manufactura
Av. Vasconia 115
Teléfono: 5523083
Fax: 5522978
Telex: 441512 VPROCT-C
Santiago - Chile

April 17, 1995.

Ms.Barbara Urzúa
Executive Vice-President
FTA Office
AMCHAM CHILE

Dear Ms. Urzúa,

CHILE - NAFTA ACCESSION

Further to our previous conversations on this subject, this confirms the Procter & Gamble Company's full endorsement of Chile's accession to the NAFTA. As you know, our Chairman of the Board and CEO, Mr.Edwin L. Artzt, chaired the U.S. President's Advisory Committee on Trade Policy and Negotiations NAFTA Extension Task Force. The Task Force's recommendation to the USTR office was to press ahead immediately with negotiations, aiming to complete them during 1995.

Our company has made a long-term committment to Chile, as evidenced by the significant direct investment we have made in the country over the past decade. This recognizes the sound economic policies pursued by Chile, and the pro-business, free-market regulatory climate which has prevailed consistently during this period.

Approving Chile's accession to NAFTA will be a recognition of the country's consistent progress in this regard, and consequently an encouragement to the balance of Latin America to persevere in market reforms. We think that moving ahead now is particularly critical, in order to restore confidence in Latin America, given recent developments elsewhere in the area.

Beyond these considerations, tariff elimination will generate a significant reduction in our cost structure locally, improving our ability to provide superior value to the Chilean consumer.

Please count on us for continuing support of Amcham's efforts in this regard.

Sincerely,

Edward D. Jardine
General Manager

cc. Mr.E.Ferraris
Mr.A.Maurogordato
Mr.A.Z.Villanueva

EDJ/srs.
056-95

Chairman CRANE. Thank you, Ms. Urzuá. Let me reassure you your entire written testimony will be submitted for the record.

Mr. Lehmann.

STATEMENT OF RICHARD O. LEHMANN, DIRECTOR OF PUBLIC AFFAIRS, INTERNATIONAL BUSINESS MACHINES CORP., ON BEHALF OF THE NATIONAL FOREIGN TRADE COUNCIL, INC.

Mr. LEHMANN. Thank you, Mr. Chairman.

My name is Rich Lehmann and while IBM signs my paycheck I appear today on behalf of the NFTC, National Foreign Trade Council, Inc., a group of 500 companies who collectively account for 60 percent of U.S. nonagricultural exports.

I will be brief, sir.

I have four major points. No. 1, the NFTC supports Chilean accession to the NAFTA and I will not repeat the compelling arguments put forward in support of accession made by my copanelists and by Ambassador Barshefsky this morning.

No. 2, the NFTC members feel strongly that U.S. negotiators, Congress, and the private sector must work together to ensure that Chile's accession does not entail any retreat from key NAFTA provisions. Several of these described in our written statement include intellectual property, investment, government procurement, trade and services, and dispute settlement.

No. 3, there are areas described in greater detail in our statement where we could use the opportunity of the Chilean accession negotiations to create further liberalization in NAFTA provisions in some sectors where there was not sufficient liberalization in the initial agreement.

No. 4, with respect to the side agreements, the NFTC has no objection to NAFTA partners and Chile working together and coordinating ways to improve environmental and labor conditions in the four countries. These issues are important and our members take them seriously. However, we strenuously object to the use of trade sanctions as a means of penalizing the nonattainment of such social policy goals. This would unfairly and unwisely hold trade liberalization and the resulting benefits to U.S. firms and workers hostage to a nontrade agenda.

In conclusion, the NFTC supports Chilean accession. We congratulate you on these hearings and hope they will be a way to jump start this process. We look forward to working with you throughout it.

[The prepared statement and attachment follow:]

NATIONAL FOREIGN TRADE COUNCIL

TESTIMONY OF RICHARD O. LEHMANN
DIRECTOR OF PUBLIC AFFAIRS
INTERNATIONAL BUSINESS MACHINES CORPORATION

ON BEHALF OF

NATIONAL FOREIGN TRADE COUNCIL, INC.

BEFORE

SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
HONORABLE PHILIP M. CRANE, ILLINOIS, CHAIRMAN

JUNE 21, 1995

Thank you, Mr. Chairman. I am Richard Lehmann, Director of Public Affairs for IBM Corporation. I appreciate the opportunity to testify today on behalf of the National Foreign Trade Council (NFTC) on the important topic of Chilean accession to the North American Free Trade Agreement (NAFTA). The NFTC also appreciates the early and constant leadership that you and other members of the Subcommittee have shown on this matter.

The NFTC's membership consists of approximately 500 U.S. manufacturing companies, financial institutions and other firms having substantial international operations or interests. Our members collectively account for over 60% of U.S. non-agricultural exports and a like percentage of all U.S. private foreign investment. Attached is a list of NFTC member organizations represented on our Board of Directors.

The Council's goal is to develop and advance policies designed to expand U.S. exports, enhance U.S. foreign investment, and improve the competitiveness of U.S. industry. Toward this end, the NFTC views the proposed Chilean accession to NAFTA as a "win-win" situation for our members and their workers, and for the United States as a whole.

The increasingly vital role played by American exports in promoting U.S. economic growth and generating and preserving jobs in this country simply cannot be overstated. The U.S. Department of Commerce estimates that each $1 billion in exports support 19,100 U.S. jobs, in large, medium and small firms. One in six U.S. manufacturing jobs is now directly or indirectly related to exports. U.S. jobs in export industries pay 13% more than the average U.S. wage. Exports accounted for almost 12% of U.S. economic output in 1993, up from about 5% in 1970. And from 1988 to 1993, exports accounted for almost 50% of total U.S. economic growth.

Chile may not represent anything close to the largest U.S. export market; but it is a market that is growing more rapidly than much of the developing world. Markets such as Chile are expected to grow twice as fast as those in the developed world over the next decade. These are the markets of the future, and the United States must avail itself of every means possible to gain access to them.

Not only does Chile's NAFTA accession afford American exporters access to a key growing market -- arguably one of the most important in Latin America -- but it grants us such access preferentially. American exporters and workers will get to realize benefits for which our foreign competitors can only wish.

As a general rule, NFTC members prefer a multilateral approach to trade and trade and investment liberalization. However, when the opportunity to achieve preferential access to a dynamic and developing market like Chile presents itself, it would be imprudent -- indeed, potentially damaging -- for the United States to let such an opportunity pass us by. Any such opportunity that passes us by will certainly be an opportunity that the French, Germans, Japanese, or Brazilians are quick to seize. In other words, the global economy will not wait on the United States.

NFTC members feel strongly that U.S. negotiators, Congress and the private sector must work together to ensure that Chile's accession to the NAFTA does not entail any retreat from key NAFTA trade-related provisions, as negotiated by the United States, Mexico and Canada. Indeed, NFTC members view the negotiations involving Chile as a way to improve on the results of both NAFTA and the Uruguay Round of GATT Negotiations; as a way of showing developing countries how they can achieve even greater access to the world's developed nations if they, in turn, agree to higher standards of trade and investment liberalization than we have achieved across a broader spectrum of more than 125 countries.

Let me mention a few of the key NAFTA provisions from IBM's standpoint. First, on the issue of tariffs and rules of origin, tariffs on computers and computer parts will be eliminated between the NAFTA countries by 1999. By January 1, 2004, all three countries will also have a common external tariff for computers and computer parts. During the period from January 1, 1994, to January 1, 2004, the NAFTA countries will operate under a transitional rule of origin. After the year 2004, no rule will be necessary.

On intellectual property, the NAFTA protects computer programs as literary works for 50 years and gives copyright owners of computer programs the right to prohibit the rental of their products. It also protects patents for a minimum of 20 years and will provide protection for patents in the approval process. Trademarks, trade secrets, and designs of integrated circuits are also protected. Initial registration of a trademark is for 10 years, renewable for successive terms of not less than 10 years. No country may limit the duration of protection for trade secrets, and the term of protection for semiconductor mask designs is at least 10 years. In addition, the NAFTA limits the countries' ability to impose compulsory licensing on patent holders and provides for increased enforcement of intellectual property rights.

Regarding investment rules, Chapter 11 of NAFTA provides a more secure environment for investment, removes many barriers to investment by eliminating or liberalizing restrictions, and provides an effective means for dispute resolution. Except as specifically provided, NAFTA guarantees national treatment and most-favored-nation status for investors from the United States, Canada and Mexico in the NAFTA region. This requirement applies both to establishment and post-establishment activity. Chapter 11 also prohibits most performance requirements and guarantees free transfer of profits and other international payments associated with investment. The Agreement outlaws expropriation, except for a public purpose, and guarantees compensation in accordance with international standards. One of the key achievements of Chapter 11 is the provision of binding third-party arbitration for disputes between an investor and the host government.

The NAFTA provisions related to government procurement make progress toward opening a significant portion of the government market in each country. For federal departments and agencies, the NAFTA applies to procurements of over $50,000 for goods and services, and over $6.5 million for construction services. For federal enterprises, the NAFTA applies to procurements of over $250,000 for goods and services, and over $8 million for construction services. Specific provisions apply national treatment, prohibit offsets (conditions imposed prior to or in the

course of procurement such as local content requirements, investment, licensing of technology, etc.), and outline procedures for tendering, qualification of suppliers and bid challenges. These provisions also will enable the U.S. Government to waive the Buy America Act for procurements over $50,000.

Regarding trade in services, the NAFTA applies national treatment to all service sectors unless specifically excluded. Licensing and certification procedures must not constitute unnecessary barriers to trade, and the NAFTA outlines measures to achieve this objective (e.g., within two years any citizenship or residency requirements for licensing must be removed). The Agreement will grant temporary entry to business persons without requiring them to obtain an employment authorization, provided that they comply with existing immigration measures relating to temporary entry. The NAFTA excludes basic telecommunications but enhanced value-added services are covered. This will ensure that reasonable conditions of access and use are available including, leasing private lines, attaching terminals and equipment, interconnection of private circuits, and using operating protocols of the user's choice.

As I noted earlier, these areas represent some of the key ones where IBM believes the United States must preserve -- and even enhance -- gains toward liberalization achieved during NAFTA. Just the same, because of the diverse manufacturing and services industries represented in NFTC's membership, the Council overall believes firmly that negotiating success in these same, in addition to other, disciplines will be central to forging broad-based business support for any final agreement expanding NAFTA to include Chile.

Following is a sampling of the benefits various NFTC member-companies expect to derive from Chile's inclusion in the NAFTA.

As the world leader in the mining and construction equipment market and major producer of gas turbine and diesel engines, Caterpillar Inc. says it "expects to be a major beneficiary of an expanded NAFTA." In fact Chile is already a good market for Cat products; company sales to that country have increased by more than 40 percent since 1992. Last year Cat exports to Chile exceeded $100 million, making Chile the company's third largest Latin American market.

As Caterpillar points out, joining NAFTA will obligate Chile to eliminate its current 11 percent duty on Cat-type products. But the proposed trade agreement will only eliminate tariffs on North American-built products. That means Caterpillar will be able to sell virtually its entire product line in Chile duty-free, while products made by Cat's Asian and European competitors will continue to be subject to Chile's high tariffs. In Caterpillar's words, it "will have a strong competitive advantage in Chile vis-a-vis its foreign competitors." The company believes this preferential market access will quickly translate into a bigger share of the market for Cat products and more work for its American employees.

Another NFTC member -- AT&T -- points out that "Chile represents a role model for the rest of Latin America based on its liberalization of the telecommunications sector." The NFTC hopes U.S. negotiators will use Chilean accession to ensure this liberalization is codified into law. In fact, Mexico and Canada should be encouraged to extend comparable market access for basic telecommunications services as Chile has done, as a way of bringing all NAFTA partners up to the same standard. This would also further support U.S. objectives within the GATS (General Agreement on Trade in Services) negotiations conducted under the auspices of the Uruguay Round of GATT (General Agreement on Tariffs and Trade) Negotiations and the WTO (World Trade Organization).

Currently, Chile imports nearly 95 percent of its telecommunications equipment, with 20 percent of that total originating in the U.S. AT&T sees the accession negotiations as an opportunity to encourage Chile to continue the steps it has already taken to open its market to participation by U.S. providers by eliminating all tariffs on telecommunications products. As these tariff eliminations or reductions would apply only to North American producers, AT&T would enjoy an advantage over its foreign rivals that would serve to make AT&T's products more price-competitive in the Chilean market.

The U.S. automotive sector also stands to benefit from Chile's accession to NAFTA. Currently there exists an 11 percent tariff in Chile on imported automobiles. If Chilean tariffs are eliminated on North American-built cars, initial General Motors estimates are that their annual vehicle sales to that country will increase by $80 million (a nearly 135 percent increase over the 1994 figure of approximately $60 million), with associated benefits and jobs for U.S. workers; again, an advantage accruing to a U.S. producer, but not to its European and Asian rivals.

Chilean accession negotiations should also be used to improve aspects of the NAFTA where existing levels of market liberalization are not as extensive as we'd like. As one example, basic telecommunications services were regrettably not included under NAFTA. Another case involves the oil and gas producing and service industry. Here we would hope that within the ongoing negotiations involving Chile, deeper commitments to liberalization will be achieved in the NAFTA government procurement and investment chapters.

While mentioning a couple of the specific areas where NFTC suggests improvements to the NAFTA could be made, we believe that U.S. involvement in the U.S.-Canada FTA and, subsequently, the NAFTA has undeniably served the best interests of the United States and enhanced the ability of American firms and workers to compete. Beyond some changes to strengthen NAFTA by expanding market access opportunities, we feel other elements of our trade agreements involving Canada and Mexico -- including in the dispute settlement area -- should remain intact as we proceed with Chile.

While the NFTC is enthusiastic and optimistic about prospects for Chilean accession to the trade components of NAFTA, we are not optimistic about chances for passing a related implementing bill through Congress should negotiations and a subsequent agreement with Chile incorporate other, non-trade-specific agendas, particularly those addressing labor and environmental matters.

Labor and environmental issues are important to NFTC members. The Council encourages the United States to pursue its labor and environmental objectives through engagement in such fora as the International Labor Organization, the Organization of American States and United Nations. Furthermore, we believe trade liberalization actually provides the resources needed to improve the environment and enhance worker rights.

But NFTC strongly opposes calls to condition trade liberalization on meeting certain social objectives. Persuading Chile to lower trade barriers is a worthy pursuit in its own right. Future efforts to open rapidly-growing foreign markets, such as Chile, will be vastly more complicated if the Chilean and future trade agreements are encumbered with the added task of setting and enforcing labor and environmental policies.

NFTC is keenly aware that some of the groups calling for linkage between trade liberalization and labor/environmental issues -- in the context of Chilean NAFTA accession and other possible U.S. undertakings in the trade negotiating arena -- have a long history of advocating protectionism. It would be tragic if after 50 years of being the catalyst for global trade liberalization, the

United States would allow these groups to erect new trade barriers through the back-door means of enforcing non-trade provisions.

Because Mexico signed on to labor and environmental side agreements to the NAFTA, some argue that there is no way the U.S. can avoid imposing the same demands on Chile as part of its NAFTA accession bid. Chile, however, is not Mexico. Unlike Mexico and Canada, Chile does not have a common border with the United States. Nor does Chile have a large population. Consequently, many of the concerns (e.g., immigration and border clean-up) that dictated the tone of political debate surrounding NAFTA have little pertinence as they relate to the U.S.-Chilean trading relationship.

In conclusion, and to reiterate with emphasis, the NFTC strongly supports Chilean accession to the trade provisions of the NAFTA at the earliest possible time. We look forward to working with the Committee on Ways and Means to help make this a reality.

Again, thank you for the opportunity to present the National Foreign Trade Council's thoughts on this issue.

NATIONAL FOREIGN TRADE COUNCIL, INC.

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Citibank
Colgate-Palmolive
Dewey Ballantine
Digital Equipment Corp.
Dresser Industries
Duracell
E.I. du Pont de Nemours
Eastman Kodak
Ernst & Young
First National Bank of Chicago
General Electric
General Motors
Gillette
Halliburton
IBM
ITT
Ingersoll-Rand
J.P. Morgan
Johnson & Johnson
Mars Incorporated
McDermott
Mobil Oil
Monsanto
Pepsi-Cola International
Pfizer
Price Waterhouse
Procter & Gamble
Ridgewood Partners
Rockwell
Steptoe & Johnson
Texaco
Towers Perrin
W.R. Grace & Co.
Warner-Lambert
Westinghouse

Chairman CRANE. Thank you, very much, Mr. Lehmann.

As I think you are aware, the bell has just rung and that means that we have another vote in progress. So I think at this moment we will recess for approximately 10 minutes with the understanding that Mr. Liebenow, I do not know what your plane connection is, but if any of you are going to be missing planes, feel free to depart. Otherwise, if you could stay until we get the Members back here, we would like to throw some questions your way.

Mr. Liebenow, if you think you have a problem, flying all the way back to Santiago is a good overnight.

We will stand in recess for 10 minutes.

Thank you.

[Recess.]

Chairman CRANE. The subcommittee will come to order.

Mr. Liebenow, oftentimes opponents of free trade say that such matters or agreements, rather, only matter to multinationals that have production facilities around the world.

Could you elaborate a little bit on how you feel small and medium-sized businesses like yours would be affected by extending NAFTA to Chile or, for that matter, to the rest of the hemisphere?

Mr. LIEBENOW. Certainly. In fact, I think that in a number of respects the importance of NAFTA and the accession of Chile and the eventual Free Trade Agreement of the Americas is perhaps even more important to small and medium businesses. I think the reasons for that are several.

First of all, very often small and medium-sized companies are producing products which may also be produced in the local economy and, therefore, if there is not full access to that market, we often find ourselves totally excluded from it. Whereas, more often, the larger U.S. corporations have products where the technology is such that they are able to sell their products in markets that are even more protected.

In our case, for example, with Mexico, we were simply excluded from that market until Mexico opened its market and the same happened with Chile and Argentina.

In addition, companies that are of a smaller size need, perhaps even more, the stability and the continuity of the rules of the game because we do not have access to all of the resources that it takes to deal with complicated trade problems in individual countries. Therefore, as these markets are opened and as the rules of the game are made simpler and more universal, it is of enormous help, in my opinion, to American small and medium-sized companies. The experience, in this respect of the textile industry, is true for so many smaller companies.

I think that is why there is such clear support on the part of the U.S. Chamber of Commerce for this program and it is because that is the future growth for all of us is in the export market. These are precisely the kinds of things that are helpful to us in being able to take advantage of those opportunities.

Chairman CRANE. Now, that is most encouraging. Ms. Urzuá, again, I want to express my deep appreciation to you for the inconvenience that you suffered to get here. We warmly welcome you today.

As the only representative of Chile, how would you assess the prospects for concluding this agreement quickly and are there any major hurdles that you see?

Ms. URZUÁ. The only major hurdle that I see is here in the U.S. Congress, getting fast track through and sorting out the differences that you have on the labor and environment issues. I do not see any major negotiating points that will hold up this process.

On the contrary, I think it will be very fast. I just think we need to get fast track in place.

Chairman CRANE. One question that comes to my mind is time constraints here as witnessed today. I said based upon—you were not able to view it, I am sure, but—the experience that just happened on the floor was the rowdiest of all the 25 years I have been in Congress. It increasingly reminds me of the British Parliament in session rather than the House of Representatives.

But the fact is that fast track probably will not be completed until September. Now, my concern is are the negotiations going forward on the part of our Trade Representative with the representatives from Chile without a fast track?

But then Chile could capitalize as soon as it is passed and the consummation of whatever agreements have been negotiated, operating on the assumption that there will be fast track approval is something that I truly hope for. Because it is the hope of all of us on this subcommittee and the full committee that we could consummate this before the end of the year ideally. The farthest out, January or February of next year.

Because I think there are real potential problems if it extends well into next year because of our Presidential election and there will be candidates campaigning both here on the floor, as well as back home.

So, at any rate, we hope and pray that is the way it works out.

Mr. Lehmann, your testimony states that the National Foreign Trade Council believes that most components of the NAFTA and the U.S./Canada FTA, including the dispute settlement mechanism, should remain in tact.

There are some groups counseling that chapter 19 dispute settlement process not be extended to Chile.

Do you know why your members believe that should be?

Mr. LEHMANN. While neither IBM nor the NFTC have had any direct interest before the chapter 19 process, overall it seems to have worked well with only a limited number of cases arising to the extraordinary challenge stage. The three cases that have come to the extraordinary challenge committees concern application of U.S. antidumping or countervailing duty statutes.

My observation with respect to antidumping and countervailing duty statutes is there is seldom a case where both sides are happy with an outcome.

I think the nature of these cases is such that it is very, very difficult for the parties involved to come to a compromise. But there has only been three of them and the dispute resolution more broadly seems to have worked very, very well.

I would also add that as Mexican tariff rates come down very sharply as a result of the NAFTA, I think it is very likely that U.S.

companies are going to face an increasing number of Mexican antidumping cases.

The Mexican antidumping law is not as transparent and the procedures are not as well established as in the United States. The existence of this mechanism, as a recourse for U.S. exporters to avoid arbitrary and capricious application of laws outside the United States, is an important element that ought to remain within this trade agreement.

Chairman CRANE. A final question I have and it is to Ms. Urzuá, but any of the others of you, too.

There have been some expressions made suggesting that the agreement with Mexico had a direct relationship to the peso devaluation, and that there is a possibility that this could occur with other South American countries coming into a hemispheric free trade agreement.

My recollection is that you had a peso or the equivalent of a peso devaluation crisis in the early eighties, did you not, and remedied that in about 18 months. Do any of you see any dangerous parallels to—and I am not saying there is cause and effect, there clearly was not in my estimation—but any similar types of problems with other Latin American partners?

Ms. URZUÁ. No. I think, well, especially I can answer for Chile. I think on the contrary. After what has happened with the Mexican peso, the Chilean peso has revalued and continues to revalue. I think the Chilean economy is very strong and also the currency in Chile is fixed not only to the U.S. dollar, it is fixed to the Japanese yen and the German mark because of the Chilean pattern of trade.

I think that the Chilean process went through perhaps what Mexico went through, as you said, in the early eighties. It recovered from it very quickly and I think the Chilean economy today is very strong. So I do not think that should be a fear for the United States.

Chairman CRANE. Very good.

Mr. LIEBENOW. Mr. Chairman, if I could, I would like to add one further comment. I think another aspect that is important as we look at these trade agreements is that the obviously very significant crisis that took place in Mexico I think has shown in another way how important these trade agreements are. Because in normal circumstances, I think with what Mexico has gone through, there would have been a very strong tendency to return to a highly protectionistic model which would have prohibited American products from entering that country.

While it is clear we are going through a period of time where there is substantially less demand for products in Mexico because of the economic crisis, that will pass. Meanwhile we have not been denied access to Mexico because NAFTA is in place. I think from the American business community's point of view, that is a very important benefit of these trade agreements.

Chairman CRANE. I share that sentiment totally.

Thank you.

Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

I will just address my question to any member of the panel who may wish to address it. What is the fascination that we have with

the Chilean national savings rate? What might you attribute to the savings rate? What advice might you offer to us, as a matter of fact?

Ms. URZUÁ. Well, I think that it is attributable to the privatization of the Chilean pension fund system which was done over 10 years ago very successfully. It is a model that is being copied throughout Latin America. That has created a natural source of savings within the country which is tremendous. It is being copied in Peru, Colombia, and Argentina very successfully.

Mr. NEAL. Would the other members of the panel wish to comment on that? Their business experience with it?

Mr. LEHMANN. We have a positive business experience in Chile. We have a growing company—double digit growth. A large part of that growth over the past 10 years has been attributable to the stabilization and the growth of the Chilean economy based on the reforms that they undertook in the early and the mideighties.

Mr. NEAL. Thanks, Mr. Chairman.

Chairman CRANE. Mr. Hancock.

Mr. HANCOCK. No questions.

Chairman CRANE. I want to express my appreciation again to all of you and offer profound apologies for the interruptions that have occurred this afternoon and hope and pray that this is behind us.

I think we have now adjourned, mercifully. With that I wish you God speed and a safe trip home.

Ms. Urzuá, we will be down there in Santiago with the Trade Subcommittee in, I think it is, the first week of August so we will look forward to seeing you back home.

Ms. URZUÁ. We will look forward to your visit.

Chairman CRANE. Thank you.

Our next panel is the Honorable Malcolm R. Wilkey, Sidney N. Weiss, John Sweeney, and Robert Housman. We will proceed in the order I indicated with the Honorable Malcolm Wilkey testifying first.

STATEMENT OF HON. MALCOLM R. WILKEY, U.S. CIRCUIT JUDGE [RET.] AND AMBASSADOR OF THE UNITED STATES [RET.]

Judge WILKEY. Thank you, Mr. Chairman.

First, I want to express my appreciation to you, as the Chairman, and to the other members of the subcommittee for this opportunity to appear here today. I want you to know that I have an independent position. I am representing no clients. I came here entirely on my own, and I have a slightly different point of view from that that has been expressed in the papers which I have read on other views on chapter 19. I reach much the same conclusion as some of them do, but by a different route. I think you will see that if you examine my written testimony, which I trust will be made a part of the record.

There are two motivations why I am here. The first is that in my experience in the last year or so I think it is dangerous to continue or to extend the chapter 19 system.

Admittedly, we must have some form of international settlement, dispute settlement but that, I think, is now available. The three assumptions which underlay chapter 19 have now disappeared.

Second, I am here because I hope that any problems over chapter 19 will not delay the accession of Chile to NAFTA. I think that is very important and I think that fast track authority should be granted for it.

Now as to chapter 19, this was a very ingenuous temporary measure. It was said, at the time, to be fitted for Canada especially because they had the Anglo-Saxon system of law as we did. Also, it was said it would be only temporary.

I thought favorably of that when I entered the *Lumber Case* arbitration or ECC proceeding. Then as I worked over the months we encountered problems. The problems were not personal to me or my colleagues but they were problems arising from the visible defects in the system.

The major flaw, it seems to me now and in retrospect from my experience, is that chapter 19 cuts out judicial review of U.S. administrative agency action by U.S. judges. It inserts foreign judges to pass on U.S. domestic law.

I submit that the opinions in the *Lumber Case,* both at the panel and the ECC level, show that it is difficult for even good Canadian judges to accurately determine American law. I think it is going to be even more difficult for Mexico and for Chile. Mexico, I understand, has no judicial review of administrative action. Chile does. But both of them are civil law countries and they will come at it and be expected to come at it differently.

I pointed out in my written testimony, in detail, the flaws of the panel and the ECC. I will not repeat them here. But I want to emphasize that the present situation is quite different from 1987 to 1993. As I said earlier, the assumptions that underlay chapter 19, a very ingenious stop-gap measure, no longer pertain.

The Canadian legal system may be like ours, but Mexico and Chile certainly are not. So that assumption is gone. We have to deal with all three or all four systems.

Second, chapter 19 was supposed to be just temporary until substantive rules on antidumping and countervailing duties were worked out. That has not occurred in the context of NAFTA, but it has occurred in the WTO, the World Trade Organization.

Third, it was implicitly assumed, I believe, that if we did not have chapter 19 there were no other real alternatives available to give us an international disposition of an international dispute.

We do have now. We have the World Trade Organization to which Canada, Mexico, Chile, and the United States are parties. We have a very good dispute mechanism set up with that, and the design of that dispute mechanism was in accordance with many of the things urged by the U.S. representatives.

So I propose that the solution to the admitted flaws in chapter 19 is to let the U.S. courts complete the process of determining what the U.S. law is as they have been doing for 200 years. Then submit to an international tribunal—that is to say, the dispute settlement mechanism of the WTO—the question which really ought to be asked: Is the action of the U.S. agency, although consistent with U.S. domestic law, in violation of our international obligations?

That should be determined by first a panel of neutrals picked by the parties from a list maintained by the Secretariat of the WTO,

and then, on an appellate level, by a panel of three judges who are semipermanent, serving for terms of 4 years.

That alternative for settling our disputes would work much better than the experience has been under chapter 19.

The problem really, as I realize it, is the Canadian judges were being asked the wrong questions. They were being asked what is U.S. law, what does U.S. law say on this?

We ought to be asking an international panel what is the obligation under international law? Then when we get to that stage, I think, by utilizing the WTO mechanism, we will have a satisfactory solution of our possible disputes with Canada and our other partners in NAFTA.

So my conclusion is that the accession of Chile should not be delayed. That if it is felt that we cannot settle the question of chapter 19, what replaces chapter 19, in a short period of time, then the grant of the fast track authority should leave out chapter 19 and we should let Chile in without the chapter 19 question being determined until later.

Then we should set to work to determine in our own house what we want in the way of a dispute settlement mechanism and negotiate it with Canada, Mexico, and Chile.

We have already negotiated the WTO dispute settlement mechanism, and very satisfactorily, in accordance with American desires. The others have accepted it, and it would seem to me that it offers a solution.

I thank you.

[The prepared statement follows:]

STATEMENT OF HON. MALCOLM R. WILKEY
U.S. CIRCUIT JUDGE (RET.) AND
AMBASSADOR OF THE UNITED STATES (RET.)

Let me make clear my basic position: I am strongly in favor of extending membership in NAFTA to Chile now, and then to other Ibero-American countries as their economies warrant. Such action is in the best interests of the United States, economically, politically, and security-wise. The views expressed are completely my own; I represent no organization or group. My purpose in offering these views is to facilitate consideration of "Fast Track" authority by suggesting how one thorny problem may be solved.

I. WHERE WE ARE NOW.

A. THE NAFTA/FTA SUBSTITUTE APPELLATE SCHEME

Born as a temporary expedient to ensure a U.S.-Canadian agreement before a fast closing deadline, the goals of the substitute appellate scheme were laudable: more speed, more expertise, and binational/ multinational participation.

In their effort to achieve these goals, the negotiation/drafters apparently never confronted an implicit assumption that underlay their action - that for unexpressed reasons United States Article III judges (or Canadian or Mexican) could not be expected to apply fairly the AD/CVD laws regarding goods in North American commerce. If this assumption had been openly avowed, its outrageous nature might have doomed the whole scheme - particularly if the likelihood of bias in Article III judges had been compared with that in ad hoc private practitioners.

The mechanism designed was to eliminate review by the Court of International Trade (CIT, 1 judge), review by the Federal Circuit (3 judges or en banc), and possible certiorari review by the Supreme Court.

The substitute scheme consisted of two-tier review by first, a five person binational panel of trade experts, then by an Extraordinary Challenge Committee of three judges.

The binational panel of experts reviews administrative agency determinations of the Commerce Department International Trade Administration (ITA) and the International Trade Commission (ITC). This panel replaces the Court of International Trade (CIT). The panel is picked ad hoc, hence no backlog. Strict time limits are imposed on the selection of members, on the process of hearings, and on decision. The members are experts in trade law, practitioners, among the best in their field. They are not generalist judges. CIT is a one judge court, and does acquire a special expertise with years on the bench. The five person panel is split 3-2, the choice of the fifth member usually being determined by lot. Under FTA and NAFTA, the binational panel is obliged to apply the law of the country whose agency action is being reviewed.

The Extraordinary Challenge Committee is quite different. Composed of three judges or former judges who are supposed to be generalists in contrast to the trade expertise of the binational panels, the ECC reviews the binational panel's action in reviewing the agency determination. Its scope of review is limited, as indeed is the scope of review of an appellate court under the United States system. Precisely how limited has become a big problem, discussed later.

Like the binational panels, the Extraordinary Challenge Committee is also ad hoc, starts with no backlog, and is subject to strict time limits. The ad hoc nature also creates a problem. In the American scheme of appellate review the ECC replaces the Federal Circuit (or in some instances the D.C. Circuit). These two circuit courts of appeals have developed over the years a great expertise in judicial review of administrative agency

action. How generalist or specialist are the judges selected for the ECC? This too has become a problem.

There is a 2-1 split in nationality of the members. In all three cases reaching the ECC Canada has enjoyed a 2-1 majority. Yet the treaty obligation under NAFTA is to apply the law of the country whose administrative agency action is being reviewed, and in the three cases this has been the United States. Application of U.S. law by non-U.S. panelists and ECC members is a big problem.

B. FAILURE OF THE NAFTA/FTA FORMULA UNDER FTA

The binational panel of experts has failed because it has been and will be:

- *Too Expert*. The members are top flight practitioners. The inevitable temptation is to *redo* the work of the experts in the administrative agency. There is, I suspect, a tendency among these top flight practitioners to look down on the low paid government bureau experts. Redoing the work of the agency is exactly what happened in the *Softwood Lumber* case, as described in the dissenting opinion of the two American panel members and in my dissenting opinion with the Extraordinary Challenge Committee.

- *Prone to Conflicts of Interest*. The high quality of panelists may actually create conflicts of interest. The members are tops in their field, called on by a variety of clients - and expect to be in the future. They are mostly partners in large law firms. The firm has diverse interests and clients. This was so clearly proved in *Softwood Lumber* where, in my opinion, two panel members were clearly disqualified.

- *Lacking In Accountability*. After the panel proceeding, there is no accountability of the panel members. Finished with one task, they go back to private practice. They do not face the members of the bar day after day in the courtroom, as judges on an established court necessarily do.

- *Lacking in Tradition and Experience in Judicial Review of Administrative Agency Action*. The ad hoc panels have no feeling for the standards of judicial review, which in many respects is a unique American institution. There is no sense of deference to the expertise of the administrative agency, which the CIT does have. More damaging to the fairness of the system, foreigners, even Canadians, lack an essential knowledge of United States law, both substantive and procedural, or perhaps are unwilling to apply it against the traditions of their own law. Yet, the FTA and NAFTA contain a specific requirement to apply U.S. law in these cases in which the administrative action originates in the U.S.

- *Too Ad Hoc*. An administrative agency faces one problem after another in the same field. There are variations, subtleties and nuances. The agency is conscious of creating precedents by which it will be bound in the future, and to precedent in the past it looks today for guidance. Therefore the agency knows that its actions must be consistent. It must look at yesterday's case, and think of tomorrow's, while deciding the case of today. It has an institutional history on which to rely. One very clear principle of judicial review is that the court must concede to the agency an expertise in the interpretation of its own governing statutes. If the agency deviates, if it is illogical or inconsistent, then the reviewing court will set it right. Any ad hoc tribunal lacks these characteristics which are essential to a true rule of law in contrast to personal whims and interpretations of the moment.

- *Inconsistent In Its Interpretations of United States Law*. With ad hoc panels, inevitably inconsistencies in the

interpretation of the law will develop. These variations will conflict with established U.S. law as interpreted by the CIT and the Federal Circuit. For example, the importation of Honduran lumber will be governed by one law, that set by the CIT and the Federal Circuit; the importation of Canadian lumber by another, set by the latest ad hoc panel; and perhaps the importation of Mexican lumber will be governed by even a third variation, set by another ad hoc panel consisting of U.S. and Mexican trade law experts.

The same or similar criticisms can fairly be applied to the Extraordinary Challenge Committees.

The ECC is too ad hoc. The three person ECC purports to be a substitute for the Federal or D.C. Circuit. The Federal or D.C. Circuit builds its jurisprudence week by week. In my fifteen years on the D.C. circuit all judges were acutely conscious of the principles of judicial review of agency action. Our duty was to apply them to about ninety different administrative agencies. We knew we had to be consistent to be fair and within the principles of judicial review. The Supreme Court took certiorari of very few administrative law cases. It was understood that the High Court relied on the D.C. Circuit and the Federal Circuit to keep administrative law straight.

The Extraordinary Challenge Committees are too generalist. There is one expertise needed - the principles of judicial review of administrative agency action. This is a defect in the experience of both United States and Canadian judges who are eligible to serve on these ECCs. Some United States judges, even some on the approved list for nomination, are totally innocent of any knowledge or experience in judicial review of administrative agency action. Some probably never sat on an administrative law review case. The Canadians are even more lacking in this essential expertise. Their jurisprudence is different. *(See my analysis in Softwood Lumber).* In Mexico, I am informed, except for the writ of "amparo", judicial review doesn't even exist. It does exist in Chile, but naturally civil law principles would make its application somewhat different.

The Extraordinary Challenge Committees have been given too vague a grant of review power. The three opinions in *Softwood Lumber* show a total divergence between the two Canadian members and myself as to the scope of review intended by the FTA. In my view, the argument advanced by Canadian counsel and adopted without question by my two Canadian colleagues reduced the three judge committee to three judicial eunuchs. If this is correct, then no ECC can ever be a substitute at all for review by the CIT and the Federal Circuit. It was on the basis that the ECC would be a substitute for customary U.S. judicial review that this scheme was sold to Congress. The litigants have been deprived from the start - not only of life-time Article III judges, but recourse to any tribunal having similar powers. As I indicated in my dissenting opinion in *Softwood Lumber*, this does raise a constitutional problem.

It is too difficult for foreigners to apply the law of the country involved. The Canadians ought to be the most apt at bridging the gap between the two judicial systems, but I submit that they failed in *Softwood Lumber*, perhaps also in the preceding *Live Swine* case. How will the Mexicans or the Chileans cope with this system?

All panelists or ECC members can be expected to look for solutions to any legal problems from the perspective of their own country's legal traditions. This is illustrated by the three major specific failures, particularly the third, in *Softwood Lumber* to apply U.S. law:

1. The failure to appreciate that the two-tier substitute system is designed to replace the U.S. judicial review system manned by judges holding life tenure. Therefore, an Extraordinary

Challenge Committee manned by judges dispossessed of all power, three judicial eunuchs, is no substitute at all for the CIT and the Federal Circuit.

2. The failure to apply the Federal Circuit's highly relevant and mandatory holding in at least one recent case to the case at issue.

3. The failure to consider at all the legislative history, the highly specific and relevant reports of the House and Senate extraordinary Committees, dealing with the legislation in identical language of *both* 1988 and 1993. It is still incredible to me that in the Canadian opinions of 54 and 31 pages there was not one word discussing these House and Senate Committee reports. I was not able to calculate the number of individual members of the House who wrote a very clear interpretation of the language in NAFTA, taken exactly from the language in FTA, that they were enacting into law, but there were nine committees involved. In the Senate there was a report by a Joint Committee of six Committees, involving exactly 75 individual senators who subscribed without dissent to the same interpretation of the language. How this could be ignored by judges obliged to interpret and apply United States law I still cannot understand.

C. The Problem We Now Face.

Summarizing these demonstrated defects in the substitute appellate review system;

- the law of the country whose administrative agency action is being reviewed must be applied. Yet foreigners tend to ignore United States law, and to apply their own with which they have been familiar all their professional lives.

- United States administrative agency action *needs* judicial review. With all due deference to the International Trade Administration of the Department of Commerce and the International Trade Commission, their determinations might be classified as the "raw product". Experienced appellate courts know where to look for flaws. The United States' courts know to what standard it is reasonable to hold the agency. The courts keep the agencies in line by refining the raw product of the administrative process in case after case.

- Under the NAFTA procedure there is no chance for the United States courts to play this role. The raw administrative agency product goes to a binational panel, then perhaps to an Extraordinary Challenge Committee. Neither the panel nor the ECC is completely familiar with United States law, especially with the principles of judicial review of agency action.

- The major lesson learned - if *U.S. law* is to be interpreted and applied to a United States agency, we *need United States judges*. Short-circuiting, eliminating all United States courts, and throwing the agency action immediately to ad hoc binational review groups such as the panel and the ECC simply will *not* apply United States law as called for by NAFTA. At least that has been the experience so far in the three ECC cases.

II. The Path We Want to Take

Is it essential to restore the role of the United States courts, the Court of International Trade and the Federal Circuit? I say *yes*. Yet this in itself provides *no international* solution with the Canadians and the Mexicans, and perhaps next year with the Chileans.

A. Agency Action Tested Ultimately by Treaty Obligations.

If it is essential to have United States Article III judges applying United States law, and not originally multinational

panels, then we should look at bringing in multinational panels *after* United States courts have done their job under United States law. We should not ask multinational panels to interpret *United States* law.

Why should another country have a valid ground of complaint if a U.S. administrative agency acts in accordance with U.S. law as determined by United States courts? My answer is, *the only valid challenge to such action would be if the United States final action violates an obligation assumed by the United States under NAFTA or WTO (GATT) or other treaties*. Strangely, there are no *substantive* NAFTA obligations regarding AD/CVD; the Agreement does not specify any AD/CVD rules. What the panels and ECCs have been asked to do is decide if the U.S. International Trade Administration or the International Trade Commission has properly followed U.S. *domestic* law.

In other words, the binational panels and the ECCs under FTA have been giving wrong answers because they have been asked the wrong question: the Canadian judges were asked to interpret and decide what is United States law, which they are not competent to do and which they should never have been asked to do. It should be assumed that if United States courts in the normal judicial review process tested by 200 years experience reach a conclusion on United States law, that is United States law. But the U.S. courts have been cut out.

The question that a binational or multinational panel of judges should be asked is: *Does the action of the United States, although consistent with U.S. law, violate United States obligations assumed under an international treaty?* Then we will have the proper question (what is the international law obligation) put to the proper panel (a multinational panel).

So, my conclusion is that the dispute settlement body to which the complaining parties under NAFTA ought to resort should be first, multinational in composition, second, empowered to interpret NAFTA or WTO obligations. The dispute settlement body should assume that the United States agency acted within United States law if the United States courts have so held, so United States law should never be in dispute before the international dispute settlement tribunal. Only if United States law as applied in the instant case contradicts assumed treaty obligations should the United States agency action be set aside, and only to the extent it is in conflict with the assumed United States international obligations.

The test therefore is conformity with treaty obligations, not with United States law.

B. Existing Dispute Settlement Mechanisms.

If we decide that the dispute settlement body ought to be (1) a multinational tribunal and (2) empowered to interpret NAFTA or WTO obligations, not United States law, should we create one originally or is there such a dispute settlement organization in existence today which would be suitable for the NAFTA members?

We can recognize but must lay aside the dispute settlement mechanisms in the several hundred bilateral trade and investment treaties, in the private international arbitration centers such as the International Chamber of Commerce (ICC), in Paris, or the London Court of International Arbitration (LCIA), and the United Nations' Conference on Trade and Development (UNCTAD) which lacks any such organization. Similarly, the Organization for Economic Cooperation and Development (OECD) does not have highly developed dispute settlement mechanisms, and those it does have are oriented towards investment not trade. The International Centre for the Settlement of Investment Disputes of the World Bank has played a highly significant and innovative role in international dispute settlement (one reason because many bilateral investment

treaties refer to it as the mechanism for arbitration), yet it also is oriented toward investment not trade disputes.

This leaves the GATT/WTO (General Agreement on Tariffs and Trade/ World Trade Organization).[1] The result of the Uruguay Round greatly strengthened dispute settlement procedures under GATT/WTO. The basic Agreement establishes the WTO with the General Council, consisting of representatives of all the contracting parties, as the permanent continuing group executive body between meetings of the ministerial conference. While references to dispute settlement procedures are scattered throughout the twenty-one Agreements and one Understanding produced by the Uruguay Round, yet the principal document and mechanism created thereby is the Understanding on Rules and Procedures Governing the Settlement of Disputes, otherwise known as the Dispute Settlement Understanding, or DSU.

The members of the General Council also function under another name, the Dispute Settlement Body (DSB). The DSB manages all procedures under the DSU (Dispute Settlement Understanding). Although with the same membership as the General Council, the DSB has its own separate chairman, staff, and rules of procedure. In addition to managing the process, the DSB also functions as the *final* dispute settlement tribunal.

It is important to note that while the old GATT was strong in negotiation and conciliation, and the new WTO DSU does provide for an initial period of sixty days for consultation and the good offices of the Director-General, the rest of the process is a firm *adjudicatory model* with strict time limits for each step. This is what the United States strove for during the years of GATT and bargained for during the Uruguay Round.[2]

On request by an aggrieved party, the DSB establishes a three person multinational panel, selected by the parties from

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[1] Of course, NAFTA Chapter 20 review is always available to decide NAFTA countries' substantive rights and obligations under the NAFTA itself.

[2] Of key importance in evaluating the usefulness of the WTO's DSU provisions in the context of anti-dumping and countervailing duties is Article 17.6 of the agreement on implementation of Article VI of GATT 1994. This provides a very clear standard of review by the panel of the administrative agency action in the following terms:

> "In examining the matter -
> (i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned;
> (ii) the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where a panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations."

I suggest that this is extremely close to the standard of judicial review of the Commerce Department's administrative action in the *Softwood Lumber* case which I urged in my dissent. I also suggest that this provision is about as good a standard of review by an international body as we are likely to be able to negotiate in a treaty with other countries, considering the accepted divergence in standards among various countries.

names of "qualified persons" furnished by the secretariat from a permanent roster. If the parties cannot agree within twenty days, the Director-General appoints. Unless the parties request their own nationals to serve, all three are neutrals. The panel has six months (three if urgent) to render a Report to the parties. After interim review by the parties, unless an appeal is noted, the Report goes to the DSB.

Under the old GATT a unanimous vote of all members of the General Council, including the warring parties, was necessary to *approve* dispute panel recommendations. Now, the reverse is true: a unanimous vote of the members of the DSB will be required to *reject* a decision from a dispute panel or dispute appellate body. (Articles 16.4 and 17.14) The DSB *must adopt* a panel Report in a dispute within sixty days of its issuance.

Given the requirement of unanimous rejection of a Panel Report, the DSU has wisely provided for an intermediate appeal, available at the choice of the party losing before the panel. Issues on an appeal are limited to issues of law and the legal interpretations developed in the Panel Report. Appeals are heard before three members of a seven person standing Appellate Body. These seven serve four year terms, are not tied with any government, and are of recognized standing in law and international trade. Appellate review is limited to ninety days, after which the DSB must adopt the Appellate Report within thirty days, unless there is a consensus *against* the Report.

It is worth noting that while the review panels are selected for the individual case, if an appeal is taken, it goes to a semi-permanent appellate tribunal. That tribunal can review all issues of law and the legal interpretation made by the panel. Thus, even though the panels may be subject to ad hoc inconsistencies, the appellate tribunal should have a chance to develop a consistent body of international trade law applicable to this type of dispute. This would be a great improvement on what we now have under NAFTA.

Unlike GATT, under the WTO the new DSB then monitors the implementation of the adopted Panel/Appellate Report. Implementation should mean termination or phasing out of the challenged measure, but if the guilty party is reluctant, then the parties can negotiate compensation. If this fails within a reasonable time, the DSB can authorize retaliation. The DSB adoption of a Panel/Appellate Report creates an international obligation, but this obligation is not automatically implemented under national law.

Turning from procedure to substantive content, the Agreements covered by the Dispute Settlement Understanding are: Agreement on Trade in Goods (including Trade Related Investment Measures (TRIMS); Trade in Services (GATS); Trade Related Aspects of Intellectual Property Rights (TRIPS); and various Plurilateral Agreements. Application of the Dispute Settlement Understanding regarding these special Plurilateral agreements depends upon the agreement by the parties that the DSU covers a specific plurilateral agreement. There are designated agreements concerning anti-dumping, technical barriers to trade, subsidies and countervailing measures, customs valuation, and sanitary regulations.

In other words, the new GATT/WTO agreements, specifically the Dispute Settlement Understanding (DSU), already covers the subject matter of AD/CVD among the United States, Canada and Mexico. This new and much stronger dispute resolution mechanism will be appraised within four years of the beginning of WTO, ie. by 1999. Some regard the strong dispute settlement mechanism as the litmus test whether the WTO succeeds or fails.

To conclude: Chapter 19 of FTA/NAFTA as a dispute settlement mechanism has demonstrably failed; with hindsight we can see that failure was built in. Redesigning a new process that will not

only work between the United States and Canada but also take into consideration the traditions and jurisprudence of Mexico and Chile is a daunting task. The new GATT/WTO has a well thought out Dispute Settlement Understanding to which all four countries have already agreed, and to which the United States contributed much in the negotiation. In substantive issues covered it would fit NAFTA. The Chapter 19 process has been made redundant; AD/CVD disputes among the NAFTA signatories may be decided by invoking the WTO Dispute Settlement Understanding. Why not utilize the machinery already constructed?

I assume that particular decision is not within the scope of the Committee's task at the moment. In line with its assigned task, I respectfully recommend; (1) that the Fast Track authority for negotiation with Chile be granted without the dispute settlement of Chapter 19 or any other mechanism included. (2) that hearings be conducted by the appropriate committees to consider making the DSU (Dispute Settlement Understanding) of GATT/WTO a part of NAFTA. (3) that in the meantime no further proceedings under Ch. 19 be undertaken by the Executive. (4) that the hearings under (2) be designed to produce a replacement for Ch. 19 which could then be negotiated with Canada, Mexico and Chile. There is no reason to delay the basic negotiations between the three NAFTA partners and Chile while we work out what we desire as a dispute settlement mechanism.

Chairman CRANE. Thank you for your testimony. Let me reassure all of you that your entire written presentations will be made a part of the permanent record.

Mr. Weiss.

STATEMENT OF SIDNEY N. WEISS, CHAIR, TRIAL AND APPELLATE PRACTICE COMMITTEE, ON BEHALF OF THE CUSTOMS AND INTERNATIONAL TRADE BAR ASSOCIATION

Mr. WEISS. Thank you, Chairman Crane and members of the subcommittee. My name is Sidney Weiss and I am a customs and international trade lawyer in New York City, and I am speaking here today on behalf of CITBA, the Customs and International Trade Bar Association, which is a nationwide association of customs and international trade attorneys.

We have over 450 attorneys as members and I believe we are the largest organization of international trade lawyers in the country.

CITBA opposes the extension of fast track to negotiations with Chile to the extent that it would comprise the extension of binational panels. CITBA has never opposed any free trade area agreement. We do not oppose a free trade agreement with Chile. We simply oppose extension of the binational power provisions of article 19, chapter 19, of NAFTA and the Canadian Free Trade Agreement to any agreement with Chile.

We have been consistent in that ever since such panels were first proposed in 1987 and 1988, as part of the Canadian Free Trade Agreement with the United States.

CITBA members or lawyer members serve and appear before all the administrative agencies and the courts which determine customs duties and international trade disputes, antidumping duties and countervailing duties, including the Court of International Trade, the Court of Appeals for the Federal Circuit, the Supreme Court, the Customs Service, the International Trade Administration of the Commerce Department, and the International Trade Commission.

In addition, our members have served as panelists in binational panel reviews under the Canadian Free Trade Agreement and have also appeared as lawyers and advocates for clients whose cases are before such panels. So we have broad experience under the system.

We oppose the continuation of the binational panels because of the following considerations which I will elaborate upon slightly in a few minutes.

First, binational panel of review permits and directs the imposition, assessment, and collection of U.S. Government taxes without the benefit of Federal judicial review. This has never been the case in the 200-plus year history under the Constitution and we are very much opposed to it. We believe that such a system is unconstitutional and also we believe that, as a policy matter, it is unwise because the cases are not disputes of an international character and the panels replace the government institution, Federal courts which are best equipped to handle them by lawyers who are not answerable, nominated, or elected by anyone.

We also oppose the panels because they are composed of a predominantly changing array of mostly customs and international trade lawyers and these lawyers are not nominated by the Presi-

dent, not approved by the Senate, they do not take the constitutional oath of office to preserve, protect, and defend the Constitution. They are not subject to impeachment and, in fact, their interests lie, in general, not in the particular cases, but in general in representing their clients in international trade matters and in getting clients in the future.

We also oppose the panels because it creates a dual if not multiple system of review which produces two or more separate legal interpretations in the same case often times.

As you are aware, countervailing and antidumping duties are imposed by the United States to counteract foreign underpricing or government subsidies of goods imported to the United States. The determinations of the International Trade Administration and the International Trade Commission are reviewable by Federal courts.

Here we have had them replaced by lawyers whose interests are to their clients. If not to their clients directly, then to the issues that are raised by their clients from time to time. We think it is very unwise to substitute those kinds of decisions, tax decisions between a U.S. taxpayer and the U.S. Government to an international body of lawyers from several countries who are not committed to impose the law and interpret the law according to the way it is written.

We have a system in place for that and we would advocate that the system of Federal judges be maintained and be preserved. Accordingly, we ask that the system not be extended to Chile.

Thank you.

[The prepared statement follows:]

STATEMENT OF SIDNEY N. WEISS, CHAIR
TRIAL AND APPELLATE PRACTICE COMMITTEE
ON BEHALF OF THE CUSTOMS AND INTERNATIONAL TRADE BAR ASSOCIATION

The Customs and International Trade Bar Association ("CITBA"), the nation-wide organization of customs and international trade lawyers, opposes an extension of fast-track negotiating authority for any free trade agreement which would include the use of bi-national panels to review administrative decisions in countervailing duty and antidumping duty cases to determine their lawfulness for purposes of U.S. law.

While CITBA has never opposed and does not now oppose any free trade area agreement, CITBA has consistently opposed bi-national panels for review of U.S. countervailing duty and antidumping duty determinations. CITBA now reiterates its opposition and, in addition, opposes extending the bi-national panel system beyond the current NAFTA signatories.

CITBA has approximately 450 customs and international trade attorneys as members. CITBA members practice before all of the courts and agencies involved in U.S. customs and international trade proceedings and litigation, including the United States Court of International Trade, the United States Court of Appeals for the Federal Circuit (CAFC), the United States Supreme Court, and the administrative agencies which make countervailing duty and antidumping duty determinations, the United States Department of Commerce and the United States International Trade Commission. Many of our members have also appeared before the bi-national panels constituted under Chapter 19 of the United States-Canada Free Trade Agreement (US-CFTA), as well as similar panels constituted under NAFTA. Moreover, members of the association also have served as panel members in these proceedings.

CITBA's continuing opposition to bi-national panel review is premised on the following considerations:

1. Bi-national panel review permits and directs the imposition, assessment, and collection of United States government taxes (i.e., imposition and collection of United States countervailing duties and antidumping duties) without the benefit of Article III judicial review. In our view, such a system is both unconstitutional and unwise as a policy matter because (a) the cases are not disputes of an international character and (b) the panels replace the governmental institution which is intended and is best suited to adjudicate the lawfulness of agency actions for purposes of U.S. law -- Article III courts -- with an institution less well suited to perform exactly the same function.

2. Members of the bi-national panels are predominantly a constantly changing ad-hoc array of practicing international trade lawyers (whether United States, Canadian or Mexican citizens) with continuing professional responsibilities to their clients and law practices, who have not been appointed or confirmed by the United States Senate and have not taken the Constitutionally-required oath to preserve, protect and defend the Constitution of the United States. In addition to being unconstitutional, establishment of this pool of decision-makers is unwise as a policy matter because it creates the appearance of a lack of impartiality, thereby undermining legitimacy and confidence in the system.

3. Bi-national panel review creates a dual, if not multiple, system of review which produces two or more separate legal interpretations of the same trade laws, sometimes in the same case. It is constitutionally suspect since it may result in unequal protection of the laws and certainly undermines the constitutional requirement of uniform import duties. Moreover, the multiplicity of decisions is unwise as a policy matter because of the confusion and burdens it inevitably creates.

BACKGROUND

Countervailing duties are imposed by the United States to offset the effects of foreign governmental subsidies conferred on products imported into the United States. 19 U.S.C. § 1671, et seq. Antidumping duties are duties imposed by the United States when foreign goods enter the United States at less than their "normal value." 19 U.S.C. § 1673, et seq. "Normal value" (formerly known as "fair value") is generally the higher of (a) the home-market price of the product or (b) the manufacturing costs of the merchandise, plus overhead, expenses, and profits. Before countervailing or antidumping duties are imposed, the United States International Trade Commission must determine that a United States industry is materially injured or threatened with material injury, or, if such industry does not exit, whether the establishment of an industry in the United States is materially retarded by reason of the subsidized or dumped imports. Because of the method of calculating the countervailing duty or antidumping duty, many such duty determinations have tended to be among the highest of all United States taxes when calculated on an ad valorem basis.

Currently, except in cases involving imports from Mexico or Canada, antidumping and countervailing duty determinations by the Department of Commerce and International Trade Commission are reviewable at the request of importers, exporters, and United States manufacturers and their labor unions in the United States Court of International Trade, an Article III court established by Congress. Decisions of the Court of International Trade are then reviewable by the CAFC, and ultimately by the United States Supreme Court. By virtue first of the US-CFTA and then NAFTA, administrative determinations in antidumping and countervailing duty cases affecting Canadian -- and now also Mexican -- products imported into the United States are subject to review by bi-national panels consisting of experts in the international trade fields from the exporting and importing countries involved. 19 U.S.C. § 1516a(g). These panels have tended to be composed of international trade lawyers who also have clients in other antidumping duty and countervailing duty cases. Antidumping duty cases and countervailing duty cases from Mexico and Canada may be reviewed in United States Courts but only if all sides first waive bi-national panel review. Since 1989, the effective date of the US-CFTA, such a waiver has never occurred.

Bi-national panels were first proposed as a substitute for judicial review of countervailing and antidumping duty disputes in the US-CFTA. They were apparently a last-minute compromise among the parties to overcome their differences as to whether countervailing and antidumping duty measures should even exist between countries who were members of a free trade area. Rather than resolving the fundamental problem, the negotiators decided to study the issue for five to seven years and, in the interim, review countervailing duty and antidumping duty decisions in bi-national panels. The concept of bi-national panels had not been previously discussed publicly, and when it first appeared as part of the final text of the negotiated agreement, CITBA immediately objected.

CITBA's opposition to the bi-national panel provisions of the US-CFTA were set out in its statements of December 3, 1987 and March 3, 1988. By letter dated July 8, 1992, CITBA also objected to the inclusion of the bi-national panel procedure in the NAFTA. On April 25, 1995, CITBA reaffirmed its opposition to such panels. CITBA's December 3, 1987 and March 3, 1988[1] statements in opposition to bi-national panel reviews of countervailing duty and antidumping duty determinations are matters of public record. While we here briefly review and reemphasize these outlined main

[1] See Hearing Before S. Finance Committee on the U.S.-Canada Free-Trade Agreement, S. Rep. No. 100/1081, at 160-185 (1988).

points, we also readopt and reaffirm all the points we made in our prior submissions without repeating them here.

I.

LACK OF REVIEW BY ARTICLE III FEDERAL COURTS.

A. Elimination Of Article III Judicial Review Of Countervailing Duty And Antidumping Duty Determinations Is Unconstitutional.

1. In General. As stated above, antidumping and countervailing duty cases arise under statutes of the United States to remedy injury to United States industry from dumped and subsidized imports by imposing a supplemental import duty, payable to the United States, on the imported merchandise.

Prior to the adoption of the Constitution in 1787, the continued existence of the United States had become increasingly problematical because the central government under the Articles of Confederation had no compulsory mechanism by which to raise revenue to fund its operations. The various states had repeatedly rejected requests by Congress to give Congress the power to levy import duties. When New York again rejected such a request in 1786, the Constitutional Convention was called, with George Washington acting as its president, to organize the nation's form of government.[2]

Since the main purpose of the convention was to provide the central government with the authority to raise revenue by import duties (see Constitution, Article I, Section 8), each of the major plans first proposed at the convention provided that new federal courts be established (under the Articles of Confederation there were no federal courts at all) to review these customs cases. Thus, for example, the "Virginia Plan," proposed by Governor Randolph of Virginia, provided:

> 9. Resd. that a National Judiciary be established to consist of one or more supreme tribunals, and of inferior tribunals to be chosen by the National Legislature...that the jurisdiction of the inferior tribunals shall be to hear and determine in the first instance, and of the supreme tribunal to hear and determine in the dernier resort, all...cases...which respect the collection of the National Revenue...

Farrand, I Records of the Federal Convention of 1787 21-22 (New Haven, 1911, 1936, 1986) ("Records"). Competing plans submitted by New Jersey, Hamilton and Pinckney also each provided for similar new federal judicial review over tax matters. See id. at 136, 223-224, 230, 232, 237, 243, 244, 293 & 305. As the Convention granted more powers to Congress, the functions of the Federal Courts encompassed more subjects and the Judicial power that we know today in Article III became generalized so that, in James Wilson's words (referring to Congress' control over duties and trade), "the Judicial should be commensurate to the legislative and executive authority." Id. at 237, n. 18. (See also George Washington's letter of transmittal at II Records 666.) True to expectations, the first Congress as its first substantive act passed the tariff act, 1 Stat. 24.

Since that time disputes between importer-taxpayers and the government over import duties have been subject to judicial review in Courts of the United States organized under Article III of the Constitution to determine whether the duty assessed is in accordance with law. Such taxes are always levied pursuant to a

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[2] See generally Max Farrand, The Framing of the Constitution of the United States, 4-6, 45-46 (1913, reprinted 1988); Carl van Doren, The Great Rehearsal 45 (1986).

law of the United States passed in accordance with the Constitution, which grants Congress the power to levy duties upon imports. Thus, they fall squarely within federal question jurisdiction provided by Article III, Section 2. This has always been the position of the United States Government and CITBA believes that removal of such review is unconstitutional.

2. Case Law Does Not Support Bi-National Panel Review. In light of these constitutional provisions, it is noteworthy that the decision of the U.S. Supreme Court most often cited in support of the constitutionality of bi-national panels, Cary v. Curtis 44 U.S. (3 How.) 236, 11 L. Ed. 576 (1846), does not in fact provide such support. In Cary, the Court, in a 4-3 decision, interpreted a statute to extinguish one of the available procedures for obtaining judicial review of customs duty assessments: that was the common law action in assumpsit, which was the most commonly used procedure at the time, but not the only one.[3] The Court ruled that the statute as interpreted was constitutional. However, in a passage that subsequently seems to have been often overlooked, the Court majority emphasized that it did not intend to condone the constitutionality of entirely eliminating Article III judicial review in import duty cases: "[n]either have Congress nor this court furnished the slightest ground [for the assertion that under the statute, as interpreted by the Court] the party is debarred from all access to the courts of justice, and left entirely at the mercy of an executive officer." 44 U.S. (3 How.) at 250. Rather, the Court appears to have felt that other procedures for obtaining judicial review remained available. Thus, as the Supreme Court later noted, Cary v. Curtis "specifically declined to rule whether all right of action might be taken away from a protestant, even going so far as to suggest several judicial remedies that might have been available." Glidden Co. v. Zdanok, 370 U.S. 530, 549 n.21 (1962) (citing 44 U.S. (3 How.) at 250).

Accordingly, CITBA reiterates its position that withdrawing Article III judicial review from United States federal tax determinations is unconstitutional.

B. Policy Issues.

1. Review Of Agency Decisions Under U.S. Law Is Not An "International" Dispute. Since bi-national panels are essentially international tribunals, support for such panels may be based in part on the perception -- a false perception, however -- that review of antidumping and countervailing duty determinations pursuant to U.S. statute is an "international dispute" which requires some special form of "international" or "bi-national" settlement. On the contrary, it is important to emphasize that the antidumping statute and the countervailing duty statute reviewed by bi-national panels are tax-levy laws of the United States. Moreover, the bi-national panels review the agency decisions to determine whether they conform to the requirements of U.S. law -- not whether they satisfy an international standard set forth in the US-CFTA, NAFTA, or other international trade agreement.

Equally important, reviews of agency decisions under the antidumping and countervailing duty statutes are not transformed

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[3] In any event, within 36 days after Cary, Congress passed an amendment which overruled the Court's interpretation of the statute and restored the right to obtain judicial review in federal court by action in assumpsit to determine the legality of customs duty assessments. Besides the action in assumpsit, judicial review in nineteenth century customs cases was sometimes obtained by other common law forms of action, such as the writ of trover, e.g., Tracy v. Swartwout, 35 U.S. (10 Pet.) 80 (1836), and sometimes by the importer's refusing to pay the bond given to secure duty and forcing the government to sue to obtain payment on the bond. E.g., United States v. Kid, 8 U.S. (4 Cranch) 1 (1807).

into international or bi-national cases by virtue of the parties to the cases. As noted earlier, the statutes impose supplemental duties on products imported into the United States. The importer is the party responsible for paying these duties. Thus, even from the perspective of the importing interests, antidumping and countervailing duty cases present a conflict between the U.S. government and U.S. taxpayers -- usually corporations. Of course, the cases also present a conflict between U.S. citizens and the U.S. government where the agency decisions are challenged by the domestic industry or labor union petitioner. In contrast, no duties and no penalties are assessed against foreign corporations or citizens, much less against foreign governments.

The non-international nature of the case is not altered by the fact that many of the importers are frequently, but not always, corporate subsidiaries of foreign companies. These corporations are organized under the laws of the states of the United States and, hence, are United States companies subject to the laws of the United States. To argue that collection of import duties from U.S.-incorporated subsidiaries creates an "international dispute" produces two classes of corporations in this country: those which are subsidiaries of foreign corporations and thereby subject to some form of "international dispute" and those which are not. On the contrary, like all citizens of the United States, corporations organized under the laws of the states and doing business here are provided remedy for unlawful imposition of Customs duties in the Court of International Trade and its appellate tribunals, the CAFC and United States Supreme Court.

Even to the extent some of the respondents to the administrative proceedings under the antidumping and countervailing duty laws may be foreign citizens or corporations, the use of bi-national panels to review the administrative decisions in antidumping and countervailing duty cases -- as a substitute for domestic courts -- is not justified under traditional principles of international law. Traditionally, most international tribunals deal with government-to-government claims, and an international claim arising from a decision by an administrative agency affecting a foreign citizen or corporation could not even be raised until completion of normal judicial review of the administrative decision in domestic courts. The Restatement, Third, of the Foreign Relations Law of the United States, § 902, comment k, explains that: "Under international law, before a [country] can make a formal claim on behalf of a private person, ... that person must ordinarily exhaust domestic remedies available in the responding [country]"; accord, e.g., James L. Brierly, The Law of Nations 281-82 (6th ed. 1963); Ian Brownlie, Principles of Public International Law 494-504 (4th ed. 1990)). In other words, before resort to an international tribunal is appropriate, the national courts are given the initial opportunity to review the contested government action (in the case of antidumping or countervailing duties, the administrative determinations resulting in their imposition and assessment) and, if necessary, to correct it for purposes of local law. Thus, for example, it could be appropriate for a foreign government to refer an antidumping duty or countervailing duty case to the World Trade Organization if the foreign government believes that the United States law or practice, as affirmed in an authoritative adjudication by the Article III judiciary, does not meet international norms such as those in the WTO-GATT Subsidies And Countervailing Duty Code or the WTO-GATT Antidumping Code. In contrast, the use of NAFTA-type bi-national panels instead of domestic judicial review introduces an entirely different structure that does not correspond to traditional principles of international law regarding the treatment of foreign citizens. Indeed, the use of NAFTA-type bi-national panels might internationalize a dispute unnecessarily, when the contested issue could readily have been resolved at the domestic level through judicial review; this is particularly true because, as noted earlier, the aggrieved party will not normally be a foreign party at all, but either a domestic industry or labor union petitioner or a U.S. citizen taxpayer.

Accordingly, international tribunals such as the WTO in antidumping and countervailing duty cases should only be considered where judicial review in Article III courts has been fully conducted but, for one reason or another, does not satisfactorily resolve the matter; international tribunals such as NAFTA-type bi-national panels which substitute for domestic courts should not be used.

2. Article III Courts Are The Government Institution Best Suited To Review The Lawfulness Of Agency Action. The premise of the bi-national panels is that, somehow, the Court of International Trade and its appellate tribunals, the CAFC and the United States Supreme Court, do not dispense justice fairly in these situations. The Customs and International Trade Bar Association informed Congress that any such allegations were groundless in 1987-1988. The judges of the Court of International Trade, being Article III federal judges, are, without doubt, the most expert and unbiased arbiters who can be found in these matters. Article III courts, moreover, remain the governmental institution which is intended, and is best suited, to be primarily responsible for adjudicating the lawfulness of agency actions in the United States.

This fundamental importance of judicial review by Article III judges in the American system of government has been articulately expressed in a leading treatise on judicial review in administrative law:

> [T]here is in our society a profound, tradition-taught reliance on the courts as the ultimate guardian and assurance of the limits set upon executive power by the constitutions and legislatures.
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> ...
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> The guarantee of legality by an organ independent of the executive is one of the profoundest, most pervasive premises of our system. ... It is clear that the country looks, and looks with good reason, ... to the courts for its ultimate protection against executive abuse.
>
> ...
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> ... [The] availability of [judicial review] is a constant reminder to the administrator and a constant source of assurance and security to the citizen.[4]

As the workings of the bi-national panels have shown, they are not a substitute for a system of jurisprudence worked out in this country over two centuries. At best, bi-national panels arguably might be able to perform the judicial function almost as well as the courts. At worst, the bi-national panels have been accused of being biased and having little or no regard for the law of the United States as interpreted by United States courts, even though it is exactly that law which they are supposed to be applying.

It is true that the judges of the Court of International Trade are reviewing the agency decisions in these matters for purposes of United States law, not international law. That is what was intended by the Constitution and Congress, since the issue is whether the decisions by the responsible administrative agency resulting in the assessment of a supplemental import duty is supported by substantial evidence and is otherwise lawful and in accordance with the will of Congress as set forth in the U.S. statutes. These are clearly judicial functions in common law countries, and they should always be carried out for the United States by federal judges as required by the Constitution.

As explained earlier, however, bi-national panels under NAFTA are supposed to review whether the administrative decisions are

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[4] Louis L. Jaffe, Judicial Control of Administrative Action 321, 324 & 325 (1965).

consistent with U.S. law, and they are supposed to apply exactly the same standard of review as the Court of International Trade and its appellate tribunals. In short, the panels are supposed to undertake the same judicial function as Article III courts, without having the same qualifications and characteristics. This has always appeared to be a poor policy and the passage of time has failed to demonstrate otherwise. See, e.g., Judge Wilkey's dissent in Certain Softwood Lumber Products from Canada, Extraordinary Challenge Committee Proceeding, ECC-94-1904-01USA (Aug. 3, 1994).

II

PROBLEMS RELATING TO PANEL MEMBERSHIP.

A. Constitutional Issues.

1. The Protections Of Independence And Impartiality In Article III. By securing review by Article III courts in litigation between taxpayers and the government in tax matters, the Constitution guarantees the taxpayer (and the government) a fair, impartial, and independent hearing of the matter. Article III, Section I provides:

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The judges, both of the supreme and inferior courts, shall hold their offices during good behavior, and shall, at stated times, receive for their services, a compensation, which shall not be diminished during their continuation in office.

Required for such hearing was a federal court with judges appointed for life and with no diminution of salary. These provisions were intended to make the judiciary as apolitical and unbiased as possible. The provisions were intended to allow the judges to hold the scales aright between the government, of which they are part, and the citizenry, of which they are also part. Writing in The Federalist No. 79, Hamilton stated the reason briefly and correctly: "[i]n general course of human nature, a power over a man's subsistence amounts to a power over his will." Outright bribery and blackmail were not what was contemplated. The very existence of easy governmental procedures (diminution of salary or executive dismissal from office, both foreclosed by the constitution) to punish the judge was recognized as a subtle power over his will to judge rightly and fairly. Nothing about human nature has changed from the drafting of the constitution to the present day.

Congress apparently thought that members of the private trade bar from the United States, Canada or Mexico would be able to lay aside all bias, prejudice, and hope for further employment to serve on bi-national panels and render fair and unbiased decisions which could not be appealed to any court. However, we believe that the appearance of a conflict in such situations is a recurring concern. Thus, we believe, as did the framers of the constitution, that persons who are not given as their sole duty in life the activity of being a judge, will not be able on all occasions to act impartially. This is especially so in cases where panel members return to their usual livelihoods of advising clients on international trade. Subconscious bias, at least, will always be a question.

Article III makes it impossible for active federal judges to sit on any bi-national panel. Federal judges are available only in federal courts. They do not give advisory opinions nor do they undertake to adjudicate matters which are not federal cases and controversies. Congress cannot impose such duties upon them, nor can they accept them. Thus, the bi-national panels are condemned to use private parties in rendering their unappealable decisions.

At times these private arbiters may be retired federal judges. Such a situation may be a plus, but it does not make a system which is operating outside the constitution into one which is operating within it.

2. The Appointment And Oath Issue. As we have discussed, the Framers, in the Constitution, guarantee the independence and impartiality of judges by insulating judges from political and economic pressures by virtue of lifetime employment and guarantee of no deduction of pay. At the same time, the Framers insured that those interpreting and enforcing United States laws would be in compliance with both the Constitution and the directive of Congress. This was accomplished in four ways. First, the Constitution provides that all federal officers be nominated by the President and confirmed by the Senate. Second, the Supremacy clause mandates that the Constitution and the laws of Congress be the Supreme law of the land, overriding conflicting state law. Third, the oath clause requires that all federal and state legislators, judges, and executive officers take an oath to be bound by the Constitution. Finally, the impeachments clause grants to Congress the right to accuse and try any federal officer who commits high crimes and misdemeanors, including failure to comply with his or her oath.

In the context of the imposition and collection of duties, these constitutional safeguards are clear: An officer nominated by the President and confirmed by the Senate is responsible for determining the rate or amount of duty to be applied in a certain case. Likewise, anyone reviewing such a determination, specifically a judicial officer, is also subject to such an appointment process. Moreover, under the Constitution, both the administrative or executive officer and the judicial officer must take an oath to preserve the Constitution and if such task shall fall to a state official, the oath is equally applicable, and the Constitution and the laws of Congress are supreme. Finally, if the executive or judicial officer shall commit some crime or misdemeanor, he or she may be impeached and tried.

Thus, under the constitutional scheme both administrators and judges deciding such cases are subject to severe sanctions should they stray from the Constitution or the laws of Congress.

However, under the bi-national panel system there are no such constraints. Indeed, perversely, in some cases, the system is designed to materially thwart these Constitutional protections. First, neither the United States nor the foreign (Mexican or Canadian) panelists are nominated by the President or confirmed by the Senate. These panelists, of course, determine the liability of U.S.-citizen taxpayers for taxes payable to the United States government. Second, the foreign panel members never take an oath to support the Constitution or the laws which were enacted by Congress. This is particularly odd in the context of bi-national panels where such panels' only function is to interpret United States import duty laws. Indeed, many panel members may not in good conscience make such an oath because they have already taken an inconsistent oath to support some other form of government. Finally, of course, while the panelists may be subject to some form of sanction, they are not subject to the constitutional sanction of impeachment. Thus, we feel, that these constitutional defects should preclude bi-national panel review.

B. Policy Issues.

The principal policy objections to the membership of bi-national panels are closely linked to the foregoing constitutional issues. Fundamentally, bi-national panels cannot achieve the independence and impartiality of Article III federal judges. At best, they may hope to come close, but as a practical matter the system has been seriously criticized. First, by virtue of using citizens of different countries, the panels increase the appearance

of politicization and nationalistic bias. Second, by virtue of using practicing trade attorneys, the panels increase the appearance of either client-related or issue-related conflict of interests. In other words, one source of possible conflict, as was alleged in the Softwood Lumber case, is that panel members or their law firms have often represented companies in the industry involved in the case. And even if the panel member has no genuine client conflict, a second possible conflict is that particular practitioners may favor a particular substantive interpretation of the law because it would help a client in a future case. These factors create an appearance of a lack of impartiality, thereby undermining legitimacy and confidence in the system.

Notably, a frequent response to the conflict-of-interest criticism is that, if taken to its logical extreme, it would eliminate large numbers of the international trade bar from membership in panels and, consequently, eliminate the main pool of expertise. In fact, this response illustrates that the panel attempt is fundamentally flawed because the goals of impartiality and expertise are too difficult to achieve simultaneously, forcing one or the other goal to be compromised.

The problem was well stated during the colonial period, when customs and international trade lawyers served on the colonial Vice-Admiralty courts which decided customs and international trade issues:

> this Gentlemen is a constant practicing attorney, in all the King's Courts here, so that when anything comes before him in the Court of Vice-Admiralty, where his clients are concerned, he is under a strong temptation, to be in their favor, to His Majesty's dishonor, and to the great discouragement of His Majesty's Officers of the customs, and should he not so act he must lose a great number of fat clients, who are of much more value to him than his post of Judge of the Vice-Admiralty.[5]

In contrast to these problems with bi-national panels, it is beyond question that Article III judges possess independence and impartiality and, when appointed to the Court of International Trade and CAFC, are able to develop specialization and expertise in the countervailing duty and antidumping duty laws.

III

THE PROBLEM OF DIVERGENT CASE LAW.

By having a system that relies on bi-national panel review for imports from some countries and CIT judicial review for imports from other countries, it is inevitable that inconsistent results and divergent lines of jurisprudence will result. While the panels are supposed to be guided by domestic law standards of review and rules of interpretation, one of the repeated criticisms of the panels is that they misapply U.S. law. See, e.g., Judge Wilkey's dissent in Softwood Lumber, supra. Furthermore, if a panel is presented with an issue of first impression, there is no assurance that the panel would decide the issue in the same way as an Article III court.

An added problem is the differing role of precedent. As courts in a common law system, the Supreme Court, the CAFC and Court of International Trade apply the doctrine of stare decisis, and the courts' legal conclusions are also binding on the agencies. Panel decisions, in contrast, do not have direct legal effect beyond the immediate case. At best, they may constitute a

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[5] Governor Jonathan Belcher of Massachusetts and New Hampshire to the Admiralty, 31 January 1742 (as quoted in M. H. Smith The Writs of Assistance Case, 58-59 (1978)).

persuasive commentary. Although panel decisions are often cited in subsequent panel deliberations, they are not authoritative or legally binding in the way judicial decisions are. The situation is even more complicated under the NAFTA with the addition of Mexico, for Mexico has a civil law system in which the doctrine of stare decisis does not exist at all.

These difficulties are compounded when a petition is filed against multiple countries, some of which are entitled to bi-national panel review and some of which are not. In addition to the legal issues, there is no assurance that panels would reach the same decision as courts under the relatively subjective "substantial evidence" test. Thus, it is entirely possible that the same factual conclusions might be sustained with respect to one country and overturned with respect to another country.

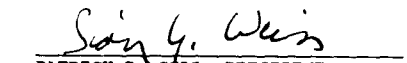
As a constitutional matter, the multiple system of review raises two issues. First, it is arguable that the system of review violates the equal protection of the laws. Second, the likelihood of divergent interpretations of the same statute undermines the requirement in Article I, section 8, that import duties must be uniform throughout the United States. As a practical matter, the multiple system of review can be extremely burdensome and confusing. Where a petition is filed against several countries, the petitioner and the agencies would be forced into the expense of simultaneously defending review proceedings before a different panel for each country involved in the case.

CONCLUSION

CITBA believed that the provisions for bi-national panel review in antidumping duty and countervailing duty cases under the U.S.-Canada Free-Trade Agreement and the North American Free Trade Agreement were unconstitutional and unwise. We believe that the serious deficiencies in bi-national review should compel Congress to withhold fast-track negotiating authority for any new free trade agreement, with Chile or any other country, which would include the bi-national panel review system.

Respectfully submitted,

CUSTOMS AND INTERNATIONAL TRADE BAR ASSOCIATION



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May 24, 1995

Chairman CRANE. Thank you, Mr. Weiss.
Mr. Sweeney.

STATEMENT OF JOHN SWEENEY, POLICY ANALYST, TRADE AND INTER-AMERICAN AFFAIRS, HERITAGE FOUNDATION

Mr. SWEENEY. Good afternoon. Thank you, Mr. Chairman, and members of the Trade Subcommittee, for inviting me to testify on behalf of the Heritage Foundation.

The Heritage Foundation, for well over a decade, has been a very strong supporter of free trade. We continue to be so.

With a gross national product of only $52 billion and a population of only 14 million people, the argument that Chile's rapid entry into NAFTA is vital to U.S. national interests may strike many Americans as an exaggeration.

Nevertheless, it would be a serious mistake to downplay the strategic importance of Chile to vital U.S. interests in the Western Hemisphere. Let me list four key reasons why the U.S. Congress and the Clinton administration should work together to make Chile the fourth signatory of NAFTA before the end of 1995.

No. 1, the leadership and credibility of the United States are at stake. At the Summit of the Americas in Miami, just 6 months ago, President Clinton announced that his administration would negotiate Chile's entry into NAFTA this year. Moreover, since 1990, two successive U.S. administrations have pledged officially on at least four separate occasions, to my certain knowledge, that Chile would be next in line for membership in NAFTA after Mexico.

For well over a decade, successive U.S. administrations, both Republican and Democratic, have been leading a hemispheric push to open up Latin America's economies, liberalize trade policies throughout the region, and encourage democratic reforms.

The nations of the Western Hemisphere expect the U.S. Government to live up to its hemispheric commitments. The governments of Latin America and the Caribbean have reacted to the Mexican crisis in the most positive and constructive way possible. They have not retreated from the challenges of budding democratic capitalism; instead, they have redoubled their efforts to move forward.

Barely a decade ago a crisis similar to Mexico's might have triggered a massive shift back to statism, protectionism, and populism, but in 1995, Latin America's collective response was to reaffirm the region's determination to press forward with the difficult process of economic and political reform.

No. 2, Chile will not wait for the United States and neither will the rest of Latin America. The Mexican crisis was a most unwelcome development creating the so-called "Tequilla Effect" which produced widespread capital flight. Yet, Latin America's democracies have redoubled their efforts to press forward.

In Chile's particular case, Chile is negotiating a closer association with MERCOSUR and is strengthening its trade relations with Mexico, Peru, Colombia, and other nations in the region.

Chile is also expanding trade and diplomatic linkages with the APEC countries and is working to strengthen its relations with the European Union.

Membership in NAFTA is not a life or death proposition for Chile. For the past 25 years, Chile has been pursuing an aggressive

policy of unilateral trade liberalization under GATT rules because the Chileans understand that trade liberalization and export diversification are the only way forward for a small developing country like theirs.

The Chileans want to join NAFTA because for Chile membership in NAFTA means, first, a level playingfield where the rules of the game are the same for everyone; second, greater institutional stability for Chile's 5-year-old democracy and its export-driven development model; and third, because NAFTA membership is the equivalent of a Good Housekeeping Seal of Approval from the world's most powerful economy.

For Chile that will translate into more foreign investment in Chile by American and other investors and it will also help to open up markets other than the U.S. market for Chilean products.

No. 3, Chile is NAFTA's anchor in South America and Chile is NAFTA's southern cone gateway to the APEC markets. Chile's membership in NAFTA is absolutely essential to NAFTA's eventual convergence with MERCOSUR into a single free trade agreement based on the benchmark NAFTA treaty.

There can be no functional Free Trade Area of the Americas in this hemisphere without Mexico, Argentina, Brazil, and Chile.

While Chile may be a small country in terms of GNP and population, it is light-years ahead of every other country in Latin America today, including Mexico, in terms of its economic performance, its policies, and its international competitiveness. This is a matter of public record.

No. 4, Chile is not Mexico and Mexico is not Latin America. Chile is not asking the United States for any bailouts or preferential treatment. The Chileans want to trade with the United States as part of their global strategy of continually diversifying and expanding Chilean exports.

To date, the only two substantive studies on the impact of Chile's entry into NAFTA indicate that Chilean exports to U.S. markets would not increase appreciably in the near-to-medium term, but that U.S. exports to Chile and U.S. investments in Chile would increase significantly from current levels.

The questionable arguments used to oppose Mexico's entry into NAFTA are completely inapplicable in the case of Chile. There is no way that any one can argue cogently that U.S. jobs would be threatened, or that U.S. companies would relocate their manufacturing facilities to Chile. Illegal immigration from Chile is not a problem.

In addition, Chile is a country that should never require a U.S. taxpayer-funded bailout of any kind. Chilean people are hard working, entrepreneurial, and they have traveled a long and difficult road from socialism, to military dictatorship, to democracy.

In conclusion, Chile is the kind of country populated by self-reliant, hard-working people that Americans traditionally have admired and respected, and we certainly should include them in NAFTA as quickly as possible.

Thank you.

[The prepared statement follows:]

Testimony for Hearings on Chile's Accession to NAFTA
by the Subcommittee on Trade
House Committee on Ways and Means
June 21, 1995

Why Chile's Accession to NAFTA
is Vital to the National Economic Interests of the United States

by John Sweeney
Policy Analyst
Trade and Inter-American Affairs
The Heritage Foundation

With a gross national product of only $52 billion and a population of only 14 million people, the claim that Chile's rapid entry into NAFTA is vital to U.S. national interests may strike many Americans as an exaggeration. After all, the GNP of the United States totals more than $8.2 trillion, which makes the U.S. economy about 159 times larger than economy of Chile. Opening a huge foreign market for U.S. exports is not an issue in the case of Chile. And Chile, unlike Mexico, does not depend on U.S. markets for its economic prosperity. Barely one-fifth of Chile's total exports are shipped to the United States. This contrasts greatly with Mexico, which does over three-quarters of its international trade with the United States. Nevertheless, it would be a mistake to downplay the strategic importance of Chile to vital U.S. interests in the Western Hemisphere.

There are four key reasons why the U.S. Congress and the Clinton Administration should work together to make Chile the fourth signatory of the North American Free Trade Agreement before the end of 1995:

• **The leadership and credibility of the United States are at stake.** At the Summit of the Americas in Miami just six months ago, President Clinton announced that his administration would negotiate Chile's entry into NAFTA this year. Moreover, since 1990 two successive U.S. administrations have pledged officially, on at least four separate occasions, that Chile would be next in line for membership in NAFTA, after Mexico. For well over a decade, successive U.S. administrations -- both Republicans and Democrats -- have been leading a hemispheric push to open up Latin America's economies, liberalize trade policies throughout the region, and encourage democratic reforms. The Caribbean Basin Initiative, the Enterprise for the Americas Initiative, the North American Free Trade Agreement, plus the Partnership for Prosperity and the Free Trade Area of the Americas to which President Clinton committed the United States last December, all form part of a longstanding, consistent U.S. policy that seeks to encourage economic development, prosperity and democratic stability throughout the Western Hemisphere.

Investor confidence is difficult to build up, and very easy to destroy. The collapse of the Mexican peso last December, only nine days after the Summit of the Americas, was a terrible blow to confidence in Latin America -- those affected included both international investors, as well as many Latin Americans involved directly in the challenge of leading their countries through a difficult process of transformation from inward-looking, inefficient, uncompetitive and statist economies, into export-driven, efficient and competitive nations in which private enterprise and civil society are the principal motors of economic and democratic progress.

The nations of the Western Hemisphere expect the U.S. Administration to live up to its hemispheric commitments. The governments of Latin America and the Caribbean have reacted to the Mexican crisis in the most positive and constructive way possible. They have not retreated from the challenges of budding democratic capitalism. Instead, they have redoubled their efforts to move forward. Barely a decade ago, a crisis similar to Mexico's might have triggered a massive shift back to statism, protectionism and populism. But in 1995, Latin America's collective response -- with the exception of Cuba's communist dictator -- was to reaffirm the region's determination to press onward with economic and political policies designed to make the region's economies more competitive, efficient and democratic.

Chile's rapid accession to NAFTA is critically important, both for substantive and symbolic reasons. In substantive terms, it would strengthen U.S. leadership and negotiating power in the process of turning NAFTA into a Free Trade Area of the Americas. In symbolic terms, it would send the hemisphere's struggling democracies a powerful message that the United States is not backing away from its hemispheric responsibilities.

• **Chile will not wait for the United States, and neither will the rest of Latin America.** The Mexican crisis was a most unwelcome development, creating the so-called "Tequila Effect" that produced widespread capital flight. Investors have taken tens of billions of dollars out of Latin America's emerging markets since last December because they mistakenly equated Mexico with every other country in the region. However, while Latin America's democracies have been disheartened by the resurgent wave of anti-trade sentiment that welled up in America following the peso's collapse, they have not abandoned their commitment to pushing ahead with the region's reform and modernization. Instead of quitting, practically every government in Latin America has taken action to prevent Mexico-style crises in their own economies. Argentina is the most telling example of this positive behavior, which the U.S. would do well to reinforce by extending NAFTA membership first to Chile, and subsquently to Argentina. Six months ago, Argentina was perceived widely as the next candidate in line after Mexico for a major financial crisis, but the Menem Administration responded with tough policy adjustments that prevented a banking crisis in Argentina, and bolstered the confidence of international investors.

Meanwhile, Chile is negotiating a closer association with the Mercosur countries, and it is strengthening its trade relations with Mexico, Peru, Colombia and other Latin American countries. Chile is expanding trade and diplomatic linkages with the APEC countries, and it is working to strengthen its trade relations with the European Union. The United States can choose to respond proactively, by living up to its commitments to the hemisphere's democracies, and in particular to its formal pledges to Chile. Alternatively, the U.S. can choose to ignore a historic opportunity to reaffirm its natural leadership in the Americas by turning the aftermath of the Mexican crisis into an unparalleled opportunity for progress throughout the hemisphere. In my opinion, ignoring this opportunity would weaken U.S. leadership and credibility throughout the Americas, and would constitute a major setback for the cause of capitalist democracy in the Western Hemisphere.

Membership in NAFTA is not a life or death proposition for Chile, which today is both an APEC nation, and perhaps the closest thing to a Switzerland in Latin America. For the past 25 years, Chile has been pursuing an aggressive policy of unilateral trade liberalization under GATT rules, because the Chileans understand that trade liberalization and export diversification are the only way forward for a small developing country like theirs. The Chileans want to join NAFTA because, for Chile, membership in NAFTA means (1) a level playing field where the rules of the game are the same for everyone, (2) greater institutional stability for Chile's five-year-old democracy and its export-driven development model, and (3) because NAFTA membership is the equivalent of a good housekeeping seal of approval from the world's most powerful economy. For Chile, that will translate into more foreign investment in Chile by American and other investors, and it should also help to open up markets other than the U.S. market for Chilean products.

• **Chile is NAFTA's anchor in South America, and Chile is NAFTA's Southern Cone gateway to APEC markets.** Chile is both a member of APEC and a Southern Cone country. Chile's membership in NAFTA is absolutely essential to NAFTA's eventual convergence with Mercosur into a single free trade agreement based on the benchmark NAFTA treaty. There can be no functional Free Trade Area of the Americas in this hemisphere without Mexico, Argentina, Brazil -- and Chile. While Chile may be a small country in terms of GNP and population, it is light years ahead of every other country in Latin America today -- including Mexico -- in terms of its economic performance, the government's free market policies, and its international competitiveness. This is a matter of public record. For example, The Heritage Foundation's Index of Economic Freedom -- published only a few months ago -- found that Chile's economy was the freest in Latin America. Similarly, the World

Competitiveness Report produced by the World Economic Forum, based in Davos, Switzerland, found in 1994 that Chile leads every other country in Latin America. In fact, of fifteen non-OECD countries studied by the World Economic Forum, Chile was ranked fifth in overall competitiveness behind Singapore, Hong Kong, Malaysia and Taiwan, but well ahead of Mexico (now an OECD member and ranked 19 out of 23 OECD countries), Argentina, Colombia, Brazil and Venezuela.

By making Chile the fourth member of NAFTA, the United States would increase its negotiating power relative to Brazil and Mercosur. It is not a coincidence that Brazil is pushing hard for a closer relationship between Mercosur and Chile. The Brazilians understand that if Chile joins Mercosur before becoming a member of NAFTA, then Mercosur's negotiating power in any future trade talks with the United States would be significantly stronger. The Brazilians also understand that if Chile joins NAFTA, it is likely that Argentina would tilt even more strongly towards NAFTA than towards Mercosur. Does it matter which way Chile and Argentina tilt? Yes, it matters very much, because the concept underlying the creation of a Free Trade Area of the Americas is that NAFTA should be the benchmark treaty. By bringing Chile into the fold now, the idea that NAFTA must be the cornerstone of an FTAA would be reaffirmed. This is especially important now that Brazil and the United States are trying to improve their bilateral relationship. Historically, relations between the United States and Brazil have been cool. Brazil has the largest economy in Latin America, and despite the chronic four-digit inflation Brazil has suffered in recent years, it has also boasted one of the hemisphere's fastest-growing economies.

• **Chile is not Mexico, and Mexico is not Latin America.** Chile is not asking the United States for any handouts, bailouts, or preferential treatment. The Chileans want to trade with the United States as part of their global strategy of continually diversifying and expanding Chilean exports. To date, the only substantive studies on the impact of Chile's entry into NAFTA indicate that Chilean exports to U.S. markets would not increase appreciably in the near to medium term, but that U.S. exports to Chile, and U.S. investment in Chile, would increase significantly from current levels. The arguments used to oppose Mexico's entry into NAFTA are completely inapplicable in the case of Chile. There is no way that anyone can argue cogently that U.S. jobs would be threatened, or that U.S. companies would relocate their manufacturing facilities to Chile. Illegal immigration from Chile is not a problem. In addition, Chile is a country that should never require a U.S. taxpayer-funded bailout of any kind. Chile is a small country populated by a hard-working, entrepreneurial people who have traveled a long and difficult road from socialism, to military dictatorship, to democracy. Chileans are the kind of self-reliant and hardworking people that Americans traditionally have admired and respected.

In conclusion, extending NAFTA membership to Chile is a win-win proposition for the United States, for the American people, for Chile, and for all of Latin America. U.S. leadership and credibility in the hemisphere would be strengthened at a critical juncture in which international investors are still wavering in their commitment to Latin America, in which popular support for free market policies remains shallow throughout the region, and emerging democratic institutions are still weak. The United States will be a net loser -- economically and politically -- if our policymakers fail to seize the initiative in this moment of opportunity.

Chairman CRANE. Thank you, Mr. Sweeney.
Mr. Housman.

STATEMENT OF ROBERT F. HOUSMAN, SENIOR ATTORNEY, CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW

Mr. HOUSMAN. Thank you, Chairman Crane, members of the subcommittee, for this opportunity to appear before you today to testify on Chilean accession to the NAFTA on behalf of CIEL, the Center for International Environmental Law.

Let me start by setting the record straight. In contrast to what some of the other testimony would have you believe, as to CIEL, we have no record of protectionism and, in fact, we strongly support properly conducted trade liberalization.

Some might even qualify us as an international service organization that is both dependent upon and serves to promote open borders and the rule of law. In fact, CIEL will soon open a Geneva office, so I do not know how we could be more involved in international trade than we already are.

Having set the record straight, let me now turn to what appears to be the foremost issues of the day—perhaps even a deal-breaking issue—whether or not fast track should include environmental goals and objectives and whether or not the Chilean package of accession agreements should also include environmental goals and objectives, or more precisely, an environmental side agreement.

I know that members of this subcommittee have expressed concerns and reservations about including environmental matters within fast track and Chilean accession. I want to respectfully disagree with that belief and provide you with evidence as to why I believe that environmental protections should be included.

Many opponents of environmental provisions in the fast track and extending environmental provisions to Chile have argued that the reason why these provisions are unnecessary is because Chile does not share a border with the United States.

I think that that argument shows a subtle, but important, misunderstanding of the NAFTA package of agreements—in terms of the package, I am talking about the environmental side agreement and the NAFTA agreement itself.

Bearing in mind, Robert Frost's admonition never to take down a fence before you understand why it was put up, let me start by explaining what is in the NAFTA package.

The NAFTA package does not deal with cross-border environmental problems. In fact, the package deals with trade distortions caused by the lack of environmental enforcement. Let me give you evidence of this. This document I am holding up is perhaps the most contentious of the NAFTA agreements to date.

Eighty-eight paragraphs in the side agreement deal with environmental trade distortions. Only five paragraphs mention—and I would underscore the word mention, because they are bare mentions—cross-border issues.

Where cross-border issues are dealt with is, in principal, in this document, the Integrated Border Environmental Plan. This document contains 175 detailed pages of how Mexico and the United States agreed to handle cross-border issues. The border plan is not part of the NAFTA package.

When you understand that the NAFTA package, itself, does not truly deal with cross-border issues but deals with trade distortions, you begin to shed light on why this argument—that because we do not share a border with Chile we do not need the side agreement—fails.

For example, if one extended this theory of borders and trade distortions to U.S./Japanese trade, conceivably the lack of a border would preclude trade distinctions even in autos and auto parts, between the United States and Japan. Now, we all know that that is certainly not the case and never has been.

Similarly, because the NAFTA environmental side agreement deals with trade distortions caused by a lack of environmental enforcement that span noncontiguous States, is fully applicable to Chile. In fact, we are already starting to see the beginnings of noncontiguous environmental enforcement concerns arising with Chile.

We have heard recently from the U.S. salmon farmers who believe that disparities in environmental health and safety laws and law enforcement are causing them a competitive disadvantage. You have heard other groups testify today, agrarian interests, that they, too, share similar concerns.

Moreover, applying the environmental side agreement to Chile is important because it is not just Chile we are talking about. Because this will be the template for hemispheric integration in the future, we are talking about Brazil and Argentina as well.

When you look at this list of potential NAFTA entrants, the environmental dynamic looms large. Venezuela and Brazil have already challenged a U.S. environmental protection law at the WTO. Our textile manufacturers have concerns about the environmental practices of other hemispheric countries and their competitive position.

Finally, let me add that there is one other obstacle to not applying the side agreement to Chile and that is the views of our NAFTA partners.

At a meeting that you and I attended, Chairman Crane, the Canadian Government representative was emphatic that the NAFTA side agreement was a sine qua non to expanding NAFTA membership.

The Mexican Government, as I understand it, has reportedly said that they will drop out of the NAFTA side agreement, jeopardizing potentially the entire NAFTA, if we do not move forward.

Moreover, I think it is possible to deal with these issues and yet not hamstring liberalization. My written testimony provides a set of readiness criteria and milestones that I think achieves this goal quite well.

Let me close by saying we all support progress. But is it progress if we drive a car faster off a cliff? No, it is recklessness. We all want a smooth road to hemispheric trade integration.

We want to avoid these car crashes—economic, social, and environmental. As part of that process the NAFTA has set a road that can be smooth. I think we ought to expand that road and improve on it, not abandon it.

If we do so, we can think of the environmental provisions that are in the NAFTA package as guard rails against environmental car crashes. With academic guard rails in place, we have a really good trading partner in Chile and something we can all hold up as a model to the hemisphere and the world.

Thank you.

[The prepared statement follows:]

TESTIMONY OF
ROBERT F. HOUSMAN
SENIOR ATTORNEY
THE CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW
ON
CHILEAN ACCESSION TO THE
NORTH AMERICAN FREE TRADE AGREEMENT
BEFORE THE TRADE SUBCOMMITTEE OF
THE HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
JUNE 21, 1995

Chairman Crane, members of the Subcommittee, thank you for the opportunity to appear before you today on Chilean accession to the North American Free Trade Agreement (NAFTA). My name is Robert Housman, I am a Senior Attorney with the Center for International Environmental Law (CIEL) in Washington, D.C.[1]

My testimony will focus on two issues: 1) the inclusion of environmental protection in the grant of fast track authority to negotiate with Chile their accession to the NAFTA; 2) how environmental issues regarding Chile's accession to the NAFTA might be handled most effectively.

I. The Inclusion of Environmental Language in Fast Track

Perhaps, the single most contentious issue with regard to Chilean accession to the NAFTA—one which seriously threatens the ability of the NAFTA parties to bring Chile into the NAFTA fold—has little at all to do with Chile. Instead, the deal-breaking issue of the day appears to be whether the fast track authority provided to the president to negotiate with Chile, and possibly beyond, should include environmental protection within the list of goals that should be advanced by trade liberalization efforts.

I know that many of the members of this Committee have expressed the belief that such environmental matters should not be included in the fast track authority. I want to begin by respectfully disagreeing with this view, and by offering evidence as to why such environmental goals should be included in the fast track authority.

Many opponents of environmental fast track language have argued that the environmental provisions of the NAFTA package are not applicable to Chile, because Chile and the United States do not share a common border. I believe that this argument reflects a minor, but nonetheless important, misunderstanding of how the NAFTA package of agreements deals with the environment.

Thus, bearing in mind the advice of Robert Frost who once said "never take down a fence until you know why it was put up," it is important to first explain what is in the NAFTA package. The NAFTA package—the NAFTA agreement and the side agreements—simply does not focus on transborder issues. The reality is that such issues are rarely even mentioned in the NAFTA package's provisions on the environment. The main thrust of the NAFTA package, in particular the side agreement, is to control the potential distortions to trade flows that can be caused by disparate levels of environmental law enforcement.

Once one understands that the NAFTA package's environmental provisions focus on trade distortions, the theory that the NAFTA environmental provisions only apply where a common border exists falls apart. Trade distortions—environmental and other—do not require a common border. Let me prove my point by applying the

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[1]Brennan Van Dyke and David Hunter, both also of CIEL, aided in the preparation of this testimony.

border theory of environmental trade distortions more broadly. For example, if one extended this theory to U.S./Japanese trade the lack of a border would preclude any trade distortions between the United States and Japan. Imagine no trade distortions could exist in say auto or auto parts trade simply because we share no border with Japan. However, we all know this is not true. While we share no border, Japanese governmental and nongovernmental practices create substantial trade distortions in these sectors.

Similarly, whether or not two trading partners share a border has little effect on whether trade distortions exist based on different levels of environmental protection or enforcement. Therefore, because the NAFTA environmental side agreement deals with trade distortions that span noncontiguous territories, the fact that Chile has no border with the United States has simply no bearing on the applicability of the NAFTA package's environmental provisions to Chilean accession. For example, the U.S. farmed salmon industry has already raised specific concerns in testimony provided to both the Congress and the Clinton administration that the lack of environmental regulations on Chilean salmon farmers puts U.S. farmers at a disadvantage. In other words, the extension of the NAFTA side agreement is no less important in regard to Chilean accession as it was for Mexico and Canada.

Dealing with environmental issues, in particular environmental trade distortions, in the Chilean accession process is also of vital importance because we are not just talking about Chile here. Chilean accession to the NAFTA will cut the template for hemispheric integration that as currently envisioned will extend to all the nations of the Americas by the year 2005. Therefore, for those who wonder why all the fuss over Chile, my simple answer is Brazil, Argentina, Columbia, Bolivia, Paraguay, Uruguay, Peru, and so on.

If one examines this list of other potential NAFTA partners, environmental issues will loom still far larger down the road. U.S. textile manufacturers already are complaining about the disparities in competitive position caused by the failure of other Western Hemisphere nations to require basic level of environmental protection. Venezuela and Brazil, both NAFTA hopefuls, have recently gone to the WTO to challenge a U.S. environmental law requiring gasolines to become less toxic and smog causing-a law that the Congress, domestic refiners and environmental groups all agree is vital to our citizens' health and safety.

Unfortunately, our ability to deal with these issues in the future will depend largely upon how well we lay the groundwork now-that is why builders work so hard to lay a strong foundation for a home, even though the foundation itself will never be occupied.

Finally, those who would prefer not to extend the NAFTA environmental side agreement further are likely to face one other major obstacle to their approach, namely the views of our NAFTA trading partners. Recently, at the Miami Congressional Workshop on Latin America, a senior member of the Canadian government provided emphatically that Canada believes the extension of the side agreement is a sine qua non to the expansion of the NAFTA proper to any other party. While I have not heard a recent opinion on the topic from Mexico, one must wonder why Mexico would ever consent to giving Chile a deal better than the one it was given. Thus, realizing that the expansion of the NAFTA is not a sole U.S. prerogative, opponents of the extension of the NAFTA environmental agreement may find that if their opposition carries the day, the expansion of the NAFTA proper may be lost-biting off one's nose to spite his face so to speak.

II. Handling Environmental Issues in NAFTA Accession

Given that the factors laid out above clearly argue in favor of, at minimum, applying the environmental provisions of the NAFTA to Chile and beyond, the next question is how best to apply them. The environmental provisions of the NAFTA and its supplemental environmental agreement, the North American Agreement on Environmental Cooperation, the NAAEC, only ensure that parties enforce their environmental laws, not that parties have adequate, or any, environmental laws to enforce. Because not all nations in the hemisphere are at the same level, a set of criteria is needed to guide NAFTA accession. In policy circles these criteria have come to be called "readiness criteria."

Readiness criteria provide guidance to determine both when a country's domestic house is sufficiently in order to begin NAFTA accession negotiations and what order of priority should be assigned to each country in the NAFTA accession "on deck" circle. Efforts to develop such criteria have focused largely on traditional economic and trade considerations. Less attention has been paid to the environmental aspects of readiness, but the question of what environmental policies need to be in place before a country is ready to become a NAFTA party remains a major issue in the NAFTA accession process.

CIEL considers the most sensible approach to readiness criteria to be a phased-in approach. Some criteria would constitute the starting line, the point before which trade negotiations should not begin. Other criteria would serve as environmental milestones that must be met in order for the process of liberalization to continue. There are countless ways to divide up what should be starting line criteria and what should be milestones, as well as to what should not be included at all. CIEL advocates the following three-tiered approach to environmental readiness criteria.[2]

Tier 1: the Starting Line

Liberalizing trade between countries at unequal stages of industrialization and with vastly disparate environmental protection policies, without furnishing adequate environmental safeguards is just not responsible policy. Among the environmental harms that can result are transfers of dangerous chemicals and other goods, which less industrialized countries are ill-equipped to regulate; subsidization by less regulated countries of the over consumption practices of wealthier countries; and localization of the growth of highly polluting industries in less regulated countries. On the other hand, with basic legal and institutional structures in place, and the intent to place safeguards in the agreement to ensure continued progress on environmental protection, the environmental harms of trade liberalization could be minimized.

1. **Democratic Rights:** The most critical starting line criteria for environmental readiness focuses on civil and political democratic rights. Citizens must have the right to obtain access to government information and to participate in government decisions affecting their interests. For example, a country must have laws that, at a minimum, ensure that citizens receive available information, and are consulted, about projects that will significantly affect the quality of their environment. Chile has taken some important steps in providing these types of rights. For example, Articles 26-31 of Chile's new Framework Environmental Law assures the informed participation of the community in the process of reviewing Studies of Environmental Impact.

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[2]A parallel approach could also ensure that accession agreements adequately address trade-related labor concerns.

Moreover, democratic rights must be extend into areas broader than just narrow "environmental" concerns; they must pervade the entire system of government. Other democratic rights necessary to secure adequate environmental policies include the rights of association and free speech, and to be free from persecution or abuse for engaging in political advocacy. In order to enforce these rights, as well as others, a country must have an independent and impartial judiciary that is free of corruption and open to citizen participation. Again, Chile appears to meet many of these conditions.

2. **Party to the Relevant International Agreements:** Another starting line marker for NAFTA accession should be to require, at minimum, that an accessant be a party to, or otherwise generally in compliance with, multilateral environmental agreements, such as: the Montreal Protocol; the Basel Convention on Transboundary Shipment of Hazardous Wastes; the Convention on International Trade in Endangered Species; the Framework Convention on Climate Change; the London Convention of 1972; the Convention on the Law of the Sea; the Western Hemisphere Convention; and the Biodiversity Convention. Moreover, the present NAFTA parties should all be in full compliance with their obligations under the NAAEC whenever accession negotiations begin. As an aside, our NAFTA partners would be right to raise the United States failures to meet these international obligations.

On this count, Chile should push the U.S., Mexico, and Canada for assurances in the NAFTA accession agreement that the rich biodiversity of its native forests will be protected in accordance with the standards established in the Biodiversity Convention. Similarly, given Chile's special vulnerability to the effects of stratospheric ozone depletion, Chile should demand that the NAFTA parties remain in compliance with, and preferably strengthen, obligations, including those related to trade, under the Montreal Protocol. The United States should readily accede to, if not promote, these requests.

3. **Environmental Reviews of the Liberalization Process:** Building upon the environmental reviews of the NAFTA that were conducted by all three original NAFTA parties, all accessants, as well as current NAFTA parties, must be required to conduct a two-phase environmental review of the likely impacts of NAFTA accession on their environment. The first phase should occur at the earliest possible stage in the process–prior to the commencement of actual negotiations. This review must subsequently be revised once the negotiations are completed. A two-phase process is necessary because phase one is intended to enable the negotiators to identify and deal with issues that must be addressed in the negotiating process, while the second phase can identify areas where trade liberalization will require legal or regulatory protections to be addressed outside of the trade agreement. The second phase is also necessary for judging any accession agreement on its environmental merits.

Working with its current NAFTA partners, the U.S. should require Chile to undertake such a study and, unquestionably, should undertake an environmental impact assessment, itself. Negotiations should not proceed before all parties have completed reliable environmental impact assessments, with opportunity for public comment and review.

4. **Capacity to Institute and Implement an Environmental Regulatory Agenda:** Finally, an accessant must already have in place the legal and institutional capacity to institute and begin implementing comprehensive environmental policies. For example, an accessant must have an adequately staffed agency or agencies charged with environmental protection.

Again, Chile has recently taken significant steps in meeting this first-tier criteria. Chile's Framework Environmental Law of 1994 established both legal and institutional structures. CIEL is heartened to see that since 1994, CONAMA, the newly-established Chilean environmental agency, has finished drafting the regulations necessary to implement the environmental impact studies provisions of this law and has formulated the procedures for generating the primary and secondary environmental standards.

However, capacity for implementation and enforcement, even of the environmental impact studies, is still lacking. Presently, the various regional offices of CONAMA, the COREMAs, which are responsible for reviewing all of the environmental impact studies for projects within their area, are staffed only by two representatives and a secretary. Even if reviewing environmental impact studies were the COREMA's only task, which it is not, the workload would be impossibly high for a staff of two. Yet, if a COREMA fails to approve or reject a particular environmental impact study in a certain amount of time, the project is deemed to have been approved. As a result, the benefit of having established an environmental impact assessment process could be substantially wasted. Progress on meeting environmental professional staffing needs in CONAMA should be a first order priority in the early stages of accession discussions.

Chile and the present NAFTA countries should be able to meet the criteria to bring them to the starting line for NAFTA accession negotiations with minimal difficulty. The environmental issues associated with the expansion of the NAFTA presumably will be identified in the various environmental impact assessments conducted by the countries and private parties, and CIEL would expect that the negotiators will work in good faith to design acceptable resolutions to any environmental concerns identified.

In this regard, the negotiators must be committed to addressing environmental problems, even if doing so requires altering the contours of the agreement. Here, I am specifically referring to the debate over whether accession should be to the NAFTA and its supplemental agreements as they are; that is to say unchanged (CIEL calls this the NAFTA Package Approach), or whether provisions specifically suited to the issues raised by the unique factors of a Chilean accession should be included in the accession agreement (the NAFTA Plus Approach). If further study indicates that environmental issues associated with Chilean accession cannot adequately be addressed by the NAFTA and its supplemental environmental agreement, the NAAEC, the parties must be open to tailoring the NAFTA package to protect fully the environments of every country. If this need to reopen the agreement becomes apparent, CIEL would commend to your review the forward-thinking, and well-reasoned proposals for NAFTA Plus accession that Minority Leader Richard Gephardt and his staff have developed.

The primary reason that it is necessary to remain open-minded about the NAFTA Plus Approach is that the NAFTA package may be inadequate to respond to the natural resource issues likely to arise in the context of increased economic activity in Chile. For example, the citizen enforcement petition provision of NAAEC article 14, which directs the Secretariat of the North American Commission on Environmental Cooperation, the NACEC, to review petitions "asserting that a Party is failing to effectively enforce its environmental laws," may exclude laws governing natural resource exploitation. Article 45.2(b) excludes from the definition of "environmental law" any statute or regulation "the primary purpose of which is managing the commercial harvest or exploitation ... of natural resources," although "primary purpose" is defined in article 45.2(c) as relating to the particular provision in (rather than the entire) statute. Nonetheless, these articles may prevent citizens from submitting article 14 petitions

to challenge a failure to enforce laws regulating natural resource exploitation. These provisions raise uncertainties with regard to the breadth of resource protection laws that are covered under the NAFTA packages environmental provisions.

A simple Understanding of the parties (in the GATT tradition) regarding article 45.2 might suffice to clarify that natural resource protection falls within the scope of the NACEC's mandate and article 14. In other contexts, and in light of the many issues concerning natural resource exploitation that relate to Chilean accession, it may be necessary to tailor the NAFTA to ensure adequate natural resource protection.

What should be avoided here is a fixation on form over substance. It is irrelevant how the environmental problems identified in the environmental impact assessments are addressed; it is only important that they be resolved through the NAFTA process. The same need to focus on substance over form also arises with regard to issues of timing. While many environmental issues will need to be addressed at the outset of NAFTA accession negotiations, some can appropriately be address during the process of liberalization. The second and third tiers of CIEL's readiness criteria provide a mechanism for continuing progress on environmental protection along side trade liberalization.

Tier 2: The First Five Year Milestone

Five years after an accession agreement has been reached and implementation of the NAFTA by and with the accessant has begun, the accessant must have met the following criteria. First, the accessant country must have passed legislation to address substantially all, if not all, the environmental priorities identified in the environmental reviews conducted during the first-tier of the accession process. Furthermore, the accessant must have fully put in place a regulatory framework, consisting of the necessary institutions, personnel, laws, rules and regulations, needed to implement the environmental laws developed during this first five year period. Lastly, environmental laws that were already in place prior to the commencement of the accession process must now be being substantially, if not completely enforced.

Chile has already made some progress in meeting the requirements of tier-two. For example, in 1991, Chile established an Environmental Unit in the Ministry of Mining, which instituted two new policies for environmental protection in the mining sector. One policy mandated the completion of an environmental impact assessment for new mining and smelting operations. The second policy established ambient air quality standards for SO_2 and particulate matter and ordered the creation of decontamination plans for air pollution emanating from existing mines and smelters in areas that exceeded those standards. The decontamination plans require mines and smelters to meet ambient air quality standards for SO_2 by the year 2000.

According to recent data, two out of the five mines and smelters that are presently located in saturated areas have approved decontamination plans. Another has submitted a plan, but it has yet to be approved, and another is expected to submit its plan very soon. One mine and smelter, however, seems to have been officially allowed to evade the environmental ambient air quality requirements simply by resettling its workers, and therefore, the only local human inhabitants, away from the site; although the workers obviously still spend hours each day working at the site and breathing in the highly contaminated air. Such policies and others like them in Chile constitute advancement toward meeting the tier-two requirements, provided they are properly implemented.

Other indications give cause for concern that Chile may not be on the road to meeting the second-tier requirements. As this testimony has already noted, CONAMA is presently severely understaffed. What is most alarming about CONAMA's lack of resources is what the situation may suggest about the level of real political support for an effective environmental protection regime in Chile. While it is true that CONAMA has enjoyed a dramatic increase in the number of its staff, a significant chunk of its financing has come from outside financial support. It is fine to have the extraordinary expenses of building an environmental regime underwritten by outside sources, but the day-to-day operational and enforcement functions of CONAMA must become part of the budget of Chile. The NAFTA accession agreement should provide built-in assurances that the Chilean government will put some of its own muscle behind creating an effective CONAMA.

Moreover, Chile has not yet resolved outstanding land claims that have been brought forward by its many indigenous populations. If we have learned any lesson from the NAFTA process, it is that we cannot ignore the social costs of the sometimes painful process of economic reform—this is the lesson of Chiapas. We raise this issue because it is universally understood that poverty and social injustice are two of the greatest macro threats to the environment. A fair resolution of the issues raised by the indigenous populations of Chile and throughout South America is a necessary requirement both for meeting certain human rights standards and for the ultimate achievement of sustainable development.

Tier 3: The Second Five Year Milestone

With the necessary laws and institutions put in place, tier-three focuses on enforcement of the environmental laws developed. Ten years after the agreement of NAFTA accession the acceding party must be effectively enforcing its own comprehensive system of domestic environmental laws. Once this determination has been made, the NAFTA oversight of each parties' law enforcement can transition entirely over to the mechanisms provided for under the NAAEC.

Ensuring Progress and Preventing Harms

It will not be enough simply to require of NAFTA parties that they meet the milestones laid out above. In order to implement greater hemispheric trade integration without fearing for the environmental health of the region, the accession agreement must include some mechanism to oversee and enforce the parties' compliance. One option would be to instruct the NACEC or the Joint Public Advisory Committees, the JPAC, to monitor compliance. Another option would be to create a new oversight mechanism.

A more complicated issue is choosing the appropriate response to failures to meet second- or third-tier criteria. In order for the tiered approach to be credible, some form of sanction mechanism must be part of the accession agreement. The most logical and potent sanction method is to link compliance with the trade liberalization process. There is, however, tension between the desire for a strong sanction mechanism, and the desire to avoid a sanction mechanism that is too strong to ever be used. The best sanction mechanism is one that draws distinctions between significant and minor breaches—just as criminal law has felonies and misdemeanors.

Because NAFTA will not eliminate tariffs overnight, such an enforcement mechanism could easily be constructed. One option would be to impose a deceleration or freeze in the tariff phase-outs for parties that are in minor breach of the accession agreement. The number of sectors affected and the length of the deceleration or freeze should be proportional to the violation.

More substantial breaches could first provoke tariff snapbacks, and, second, expulsion from the NAFTA.

Punitive mechanisms are neither the only nor necessarily the best means by which to achieve environmental advances within the NAFTA nations. Presently, the NAFTA includes an environmental funding mechanism, made up of the Border Environmental Cooperation Commission and the North American Development Bank. However, their environmental mandates extend only to the border area between the United States and Mexico. Further, their efficacy has been seriously diminished by both funding shortages and political stresses. An expanded and improved version of the NADBank should be a part of the Chilean accession package. Nobel Laureate James Tobin has proposed a small tax on short-term international capital flows in order to prevent speculation of the kind that led to the downfall of the Mexican economy. The revenues from Tobin's tax could be disbursed for environmental restoration and protection projects, especially at the community level, through low cost loans and grants. These funds could then be used to assist new NAFTA parties to meet the requirements imposed by the second and third tiers of NAFTA accession and all NAFTA parties to develop programs to address environmental problems that result from increased international trade.

CONCLUSION

Debating whether or not the environment should be a part of Chilean NAFTA accession, or more broadly Western Hemispheric trade integration, is a lot like debating whether or not to include the foundation in the sale of a house. As hard as naysayers may try, ultimately it is impossible to separate environment from trade concerns. Why? Because you can't build a chair without wood, and you can't make wood without trees. Because you can't power the tools of industry without the fuel of the environment. Because we all breath the air and drink the water of the Earth.

The issue then is not whether we should include the environment in our trade liberalization efforts, but rather whether we will deal with these issues through blind and reckless indifference or through intelligent and coherent long-term policies.

Dealing with the environmental issues raised by Chilean NAFTA accession in an intelligent manner will require us, <u>at minimum</u>, to apply the NAFTA package to Chile and all other NAFTA accessants. Further, hemispheric integration will require us, in some way, to deal with the host of individual and particularized environmental issues raised by the special and unique circumstances of each NAFTA accessant.

CIEL believes that many, if not all, of these particularized environmental concerns can be dealt with through the creation and implementation of environmental readiness criteria. We further believe that the best approach to environmental readiness criteria is a tiered approach as described above.

The benefits of a tiered approach to NAFTA accession are substantial. First, a tiered approach provides environmental protection, while respecting the needs of developing countries to provide economic opportunities for their citizens. Second, the tiered approach allows each accessant to develop its own regulatory system, thus recognizing that there is no cookie-cutter approach to environmental protection and that all countries need not adopt one model set of laws. Third, tiering also recognizes that the process of developing environmental laws, and then enforcing them, takes time; thus, tiering provides for a transition period. Fourth, a tiered approach neatly parallels the tiered approach to trade liberalization embodied in the NAFTA itself; NAFTA does not immediately liberalize trade–the majority of its tariff reductions

and other obligations are phased in. Fifth, this approach would ensure that progress is make on environmental protection over the relatively near term without hamstringing the trade liberalization process that countries are committed to advancing.

Thank you, once again, for this opportunity to appear before you today.

Chairman CRANE. Thank you, Mr. Housman.

Mr. Sweeney, is it your view that regional free trade agreements can be crafted in a way that both complement and strengthen the multilateral trading system?

Mr. SWEENEY. Yes. I would say so. I would answer your question somewhat differently. It is my firm belief that we have a benchmark treaty which is the NAFTA with its side agreements. Whether some of us may like those side agreements or whether some of us may oppose those side agreements, we nonetheless have a benchmark treaty.

All the democratic leaders of the Western Hemisphere agreed, last December, that NAFTA would be the benchmark treaty. They all agreed to work together to bring all these bilateral free trade agreements and multilateral free trade agreements in the hemisphere together into an eventual convergence of a Free Trade Area of the Americas in which NAFTA would be the benchmark, the cornerstone of that free trade area. I hope that answers your question, sir.

Chairman CRANE. Yes, indeed, thank you, so much.

Mr. Payne.

Mr. PAYNE. Thank you, very much, Mr. Chairman.

I want to thank all of you for being here and testifying before us today. I would like to follow up for just a couple of minutes on the chapter 19 issue.

Judge Wilkey, I thought you made a very good presentation. I certainly know that you have been very involved in that, and I certainly have a great deal of respect for you and your wisdom in these matters.

Mr. WILKEY. Thank you, sir.

Mr. PAYNE. I wanted to ask you, though, about the politics of it, since I know you know a good deal about Chile.

Do you think that the Chilean Government would be amenable to your suggestion to have, to agree to accession to the NAFTA without having chapter 19 apply?

Mr. WILKEY. Yes, I do. Because I think that the Chileans might be apprehensive of chapter 19 as it now exists. Because look at it from their point of view.

What if they have three American trade experts coming down to Chile to sit on a panel of five to interpret Chilean law? Chilean law, civil law are entirely different legal systems. I do not think that they view that with delight.

I think they would be much more agreeable to looking at the dispute settlement mechanism of WTO, which they have already signed because under WTO, instead of a five-man binational panel, you get a three-person neutral panel from other countries drawn from a panel of qualified persons by the International Secretariat. On appeal, you get three neutral judges, drawn from a semipermanent bank of seven judges.

For the Chileans, the WTO would seem to be entirely preferable.

Mr. PAYNE. Let me ask your opinion about another area and that is in Canada. Do you think that the Canadians would be agreeable to dropping this chapter 19 in favor of the WTO proceeding?

Mr. WILKEY. Canada may be another problem and, a different problem, and for some very human reasons. There is always a

human tendency to defend something that you invented and are doing very well by. That is the Canadian situation.

The chapter 19 was, as I understand it, created to satisfy the Canadian concerns about American law in countervailing duties and antidumping. This was a concession to the Canadians in lieu of an agreement on the substance of the antidumping and CVD rules. So the Canadians got what they wanted in this and they have done very well with it.

So it is conceivable that the Canadians would object to alerting a system by which they are doing very well. But even the Canadians must consider the alternative.

As I pointed out, all three of the assumptions on which chapter 19 was invented have now disappeared. So the alternative for us, in the United States and for the Canadians, either is to invent a new and different system to satisfy the four countries, assuming Chile comes in, or invent a new system, or to go to the WTO.

The WTO alternative did not exist when either the Canadian treaty was made or when the Mexicans were brought in, so we do have that alternative now.

I think the Chileans would clearly accept it, and I am hopeful that the Canadians, on reflection, would accept it as the best of alternatives which, after all, they have signed up to.

Mr. PAYNE. Would it be plausible to think of chapter 19 as a solution as it relates to Canada, but not to the other nations of the NAFTA?

Mr. WILKEY. No. I do not think it would be a solution in that respect, and that is for two reasons.

First of all, I do not think we should have disparate treatments of the members of the NAFTA. That creates discrepancies in domestic law. It creates discrepancies in U.S. law.

When ad hoc panels determine one thing and the Court of International Trade determines another, and then you have a U.S./Mexican or a U.S./Chilean controversy, it gives the third solution to the same type of problem. So that would not work.

But even if we were only the United States and Canada, chapter 19 would be discarded as it was contemplated it would be. Chapter 19 should be discarded in favor, I believe, of the WTO.

Because the fundamental flaw is that we have asked Canadian judges to interpret and apply American law which then becomes binding on the U.S. executive branch.

Now, let me show you the biggest, clearest example of that. If you want to see the difficulty of Canadian or any other foreign judges applying U.S. law, look at your own subcommittee report in 1993, at the time of NAFTA, in which this subcommittee, itself, described precisely what it meant by the language which it was reenacting after it enacted the statute with Canada only.

This subcommittee's report described in detail what the language meant and this subcommittee did not change the language because it was what the committee wanted to say.

Then look at the 54-page opinion of one of the Canadian judges, and the 31-page opinion of the other. You will not find this subcommittee's report referred to in one single line.

Why? Because the Canadian judicial tradition is they do not accept and refer to legislative history. I was taught that when a sub-

committee makes a report, that is the highest form of legislative history and that is reliable guidance to what the words of the statute mean.

I might also point out that in addition to this subcommittee, the exact same language was adopted in the Senate Committee report which reflected the views of a combined six committees of the Senate. That reflected 75 individual Senators without a dissent.

Now, how an American judge could disregard that, I do not know. Of course, I relied on it as my dissent shows. But my Canadian colleagues never even mentioned it. That shows the difficulty of applying American law when it has to be applied by foreign judges.

Mr. PAYNE. Thank you, very much, Judge Wilkey.

I thank the rest of the panel.

Chairman CRANE. I want to thank all of you gentlemen for your patience and your testimony. With that, we will ask for our final panel of Robert Koch, Fred Meister, and Carolyn Gleason.

Let me welcome all of you before our subcommittee and express appreciation for your tolerance of this hectic day that we have gone through that was not determined by the subcommittee, I must reassure you, it was over on the floor.

With that, we will start with Mr. Koch first and then go down the line with Mr. Meister and Ms. Gleason.

STATEMENT OF ROBERT P. KOCH, VICE PRESIDENT, FEDERAL GOVERNMENT RELATIONS, WINE INSTITUTE

Mr. KOCH. Thank you, Mr. Chairman. My name is Bobby Koch, and I am vice president for Federal Government Relations for the Wine Institute.

On behalf of the Wine Institute, the wine growers association, representing over 400 California wineries which produce 75 percent of our nation's wine, I appreciate this opportunity to speak about the accession of Chile to the North American Free Trade Agreement.

This testimony will outline and amplify some of the reasons as to why it is necessary and appropriate to ensure that there is no further reduction of the U.S. tariff on wine and grape concentrate in any trade agreement with Chile.

Further lowering wine tariffs in a free trade agreement with Chile would be highly asymmetrical in Chile's favor. Given the dynamics, the U.S. wine industry would bear the extreme adverse consequences while Chilean wine producers would enjoy the benefits.

The California wine grape, wine, and brandy industries, collectively known as "the wine industry" have suffered greatly as a result of both domestic and international U.S. Government policies.

These have included a 529-percent increase in the Federal excise tax on wine in 1991; the Uruguay Round Agreement lowering the U.S. tariff on wines—which already are the lowest of any major wine producing country—by an additional 36 percent when other countries, including members of the European Union, are lowering their higher tariffs by only 10 to 20 percent; NAFTA's immediate opening of the U.S.-Mexican brandy market to duty-free competition from the much larger brandy market industry on an

unreciprocated basis; and last, the wine provisions in the NAFTA and the Canadian Free Trade Agreement have enabled Chile to benefit from discrimination against U.S. wines by Mexico and two key Canadian provinces.

For example, under the Mexico/Chile Trade Agreement of 1991, the tariff on Chilean wines will be reduced to zero in 1996, while U.S. wines will have to wait until 2004 for tariff elimination. This means that in 1996, U.S. wine will be burdened with a 14-percent tariff while Chilean wine will enter Mexico duty free.

Both Ontario and British Columbia imposed a higher cost of service markups on U.S. wine than on Chilean wine and all other imported wines.

In Ontario we face an 18.7-percent cost-of-service charge, while all other imports, including Chile, have a 6-percent cost-of-service charge.

Chile's exports of wines to the United States are booming in both volume and value, posing a threat to the California wine industry. The prices and types of Chilean wines have led to a significant increase in Chile's sales to the United States. Chile recently surpassed Germany to become the third largest supplier of wine to the United States. Between 1981 and 1992 the volume and value of Chilean bottled table wine exported to the United States increased nearly 17 times.

The Chilean wine industry, on the other hand, is unthreatened by import competition from the United States because current U.S. exports to Chile are negligible and future market opportunities show little promise.

Chile is positioned to rapidly expand its exports to the United States and the volume and value of Chile's exports worldwide are surging and production levels continue to grow.

Last year, the United States purchased 25 percent of Chile's wine exports. With a free trade agreement and duty-free treatment, Chile will shift a significant quantity of its growing wine supply to the United States. Chile is increasing its acreage of popular varietals such as Cabernet and Chardonnay and wine grape acreage in Chile is on the rise.

Between 1991 and 1993, alone, total wine grape acreage in Chile increased 18.5 percent, from 146,000 to 173,000 acres. California wine grape acreage, on the other hand, decreased from 363,500 acres in 1982 to 326,600 acres in 1991, a 10-percent decline.

In addition to the 20-percent decrease in domestic wine consumption since 1980, and extensive tariff and nontariff trade barriers to foreign markets, production costs in the United States continue to rise.

The industry faces high land and labor prices, combined with expensive viticultural problems such as phylloxera and Pierce's disease. Weighty regulatory obstacles also add to the industry's expenses. The price of land in Chile's grape-growing regions is well below the cost of U.S. land.

The average acre of vineyard in California's prime wine, grape-growing regions sells for between $25,000 and $40,000, while the comparable acre in Chile costs between $750 to $4,000.

In sum, since 90 percent of the U.S. wine industry is based in California the impact of any further lowering of wine tariffs be-

tween the United States and Chile will be felt most acutely in California.

California's wine growers do not want special treatment or protection. We are for free trade but insist on fair trade. Our very low tariff is not keeping Chilean wine from entering the United States. It is time to have all of our trading partners, including Chile, first reduce their wine tariffs to our low level.

Mr. Chairman, it is a pleasure to be here today to have the opportunity to testify.

[The prepared statement follows:]

STATEMENT OF ROBERT P. KOCH
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE
June 21, 1995

Mr. Chairman, Members of the Subcommittee, my name is Bobby Koch and I am Vice President, Federal Government Relations for Wine Institute. On behalf of Wine Institute, the wine growers' association representing over 400 California wineries who produce 75% of our nation's wine, I appreciate this opportunity to speak about the accession of Chile to the North American Free Trade Agreement. This testimony will outline and amplify some of the reasons as to why it is necessary and appropriate to ensure that there is no further reduction of the U.S. tariff on wine and grape concentrate (grape must) in any trade agreement with Chile.

Further lowering wine tariffs in a free trade agreement with Chile would be highly asymmetrical in Chile's favor. Given the dynamics, the United States wine industry would bear the extreme adverse consequences, while Chilean wine producers would enjoy the benefits.

The California winegrape, wine and brandy industries, collectively "the wine industry", have suffered greatly as a result of both domestic and international U.S. Government policies. These have included:

1. An over-500% increase in the Federal Excise Tax in 1991;

2. The Uruguay Round agreement lowering the U.S. tariff on wines, which already are the lowest of any major wine-producing country, by 36%, when other countries, including members of the EU, are lowering their higher tariffs by only 10% - 20%;

3. NAFTA's immediate opening of the U.S. brandy market to duty-free competition from the much larger Mexican brandy industry on an unreciprocated basis; and

4. The wine provisions in the NAFTA and the CFTA have enabled Chile to benefit from discrimination against U.S. wines by Mexico and two key Canadian provinces. For example, under the Mexico-Chile Trade Agreement of 1991, the tariff on Chilean wines will be reduced to zero in 1996, while the U.S. will have to wait until 2004 for tariff elimination. This means that in 1996 U.S. wine will be burdened with a 14% tariff while Chilean wine will enter Mexico duty free. Both Ontario and British Columbia imposed higher cost-of-service markups on U.S. wine than on Chilean and all other imported wine. In Ontario, it is an 18.7% cost-of-service charge for U.S. wines, compared to a 6% cost-of-service charge for Chile and all other wine-producing countries.

Our estimates show that over 600,000 jobs depend upon the U.S. wine industry. The time has come for the U.S. wine industry to stop being the sacrificial lamb of international trade negotiations.

Chilean Wine Exports Are Rapidly Expanding

Chile's exports of wine to the U.S. are booming in both volume and value, posing a threat to the California wine industry. The prices and types of Chilean wines have led to a significant increase in Chile's sales to the U.S. Chile recently surpassed Germany to become the third largest supplier of wine to the U.S. Between 1981 and 1992, the volume and value of Chilean bottle table wine exported to the U.S. increased nearly 17 times. From 1981 to

1992, the volume grew from 271,052 gallons to 4,554,617 gallons and the dollar value of that wine increased from $1,779,261 to $29,981,912. The Chilean industry, on the other hand, is unthreatened by import competition from the U.S. because current U.S. exports to Chile are negligible and future market opportunities show little promise.

Chile is positioned to rapidly expand its exports to the U.S. The volume and value of Chile's exports worldwide are surging and production levels continue to grow. In 1981, Chile exported 2,432,892 gallons around the world. By 1992, the volume of wine exported had increased more than seven times to 17,544,720 gallons. The value of that wine increased from $14,847,101 to $119,249,812. Last year the U.S. purchased 25% of Chile's wine exports. With a free trade agreement and duty-free treatment, Chile will shift a significant quantity of its growing wine supply to the U.S.

Chile is especially adept at producing popular varietals, such as Cabernet and Chardonnay, that constitute the fastest growing part of the U.S. wine market. Over 80% of Chilean wines are varietals that can be easily substituted for the most well liked wines in the U.S.

Chile is increasing its acreage of popular varietals and wine grape acreage in Chile is on the rise. Between 1991 and 1993 alone, total wine grape acreage in Chile increased 18.5% from 146,000 acres to 173,000 acres. California's wine grape acreage, on the other hand, decreased from 363,500 acres in 1982 to 326,600 acres in 1991, a 10% decline.

Unequal Production Costs

In addition to the 20% decrease in domestic wine consumption since 1980 and extensive tariff and non-tariff barriers to foreign markets, production costs in the U.S. continue to rise. The industry faces high land and labor prices, combined with expensive viticulture problems such as phylloxera and Pierce's Disease. Weighty regulatory obstacles also add to the industry's expenses.

The price of land in Chile's grape-growing regions is well below the cost of U.S. land. The average acre of vineyard in California's prime wine grape-growing regions sells for between $25,000 and $40,000 while a comparable acre in Chile costs between $750 and $4,000. Wine regions in Chile, well irrigated by streams from the Andes, produce high yields.

The costs of producing, picking and processing wine grapes in Chile can be extremely low. It is estimated that the cost of labor in Chile is 15 to 20% of that in the U.S. For example, a winery worker in Chile makes $8 per day with no benefits, while workers in California's Winery Employers Association make between $8.52 and $16.97 per hour, plus generous benefits.

Chile's vineyards are healthy and there is minimal need for fungicides. In the U.S., phylloxera and Pierce's disease have attacked thousands of acres of vines, all of which must be removed and replanted at substantial cost.

Land, labor, operating and regulatory costs are significantly lower in Chile as compared to the U.S. Chile's comparative advantages in the wine industry will be amplified by a free trade agreement.

Since 90% of the U.S. wine industry is based in California, the impact of any further lowering of wine tariffs between the U.S. and Chile will be felt most acutely in California. As we are all aware, the recession in California has been prolonged with continued high unemployment.

Further Lowering Wine Tariffs Will Accelerate The Growth of Chilean Exports To The U.S.

The expected growth in the supply of wine from Chile resulting from a free trade agreement, combined with competitive market conditions in the U.S. suggest that any tariff savings will be transferred into lower import prices for Chilean wines. Thus, sales of Chilean wines will directly displace sales of competitively priced U.S. wines.

Because most costs in the industry are fixed, any decline in sales volume is a net loss for U.S. wine producers. The industry needs a substantial amount of capital investment for operating costs such as replanting vineyards, delivering water and processing grapes. Given these costs, additional imports could easily force our domestic industry into a real crisis because of the resulting loss situation.

Conclusion

As the facts outlined in this testimony demonstrate, California's winemakers have not been accorded a "level playing field" on which to compete. Because of this, ensuring that there is no further reduction of the U.S. tariff on wine and grape concentrate (grape must) in any trade agreement with Chile is sound trade policy.

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Chairman CRANE. Thank you, Mr. Koch.
Mr. Meister.

STATEMENT OF FRED A. MEISTER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, DISTILLED SPIRITS COUNCIL OF THE UNITED STATES

Mr. MEISTER. Good afternoon, Mr. Chairman, and members of the subcommittee. My name is Fred Meister and I am the president and CEO of DISCUS, the Distilled Spirits Council of the United States, the trade association which represents U.S. producers and exporters of distilled spirits. We appreciate this opportunity to present our position on Chile's accession to the NAFTA and to identify the issues of key importance.

DISCUS strongly supports the accession of Chile to the NAFTA. We believe that Chile is the most appropriate candidate for accession and we are convinced that now is the appropriate time for negotiations on terms of accession for Chile.

For the U.S. distilled spirits industry, Chile's accession presents an excellent opportunity to secure enhanced access to a promising export market and to gain a competitive advantage for American spirits.

Expanding exports is essential to our members. Increased sales to Chile will make an important contribution to maintaining production and preserving jobs within our industry.

We urge U.S. negotiators to bring the negotiations with Chile to a rapid and successful conclusion, and we urge the Congress to renew fast track authority and approval procedures as soon as possible.

Chile maintains, however, a number of trade barriers which restrict access for U.S. distilled spirits exports. These include applied tariffs of 11 percent, restrictive product standards, and a very discriminatory system of liquor taxation.

We would hope that the United States would insist that Chile eliminate these barriers immediately upon accession since the U.S. market is already open to Chilean distilled spirits.

Specifically, the terms of Chile's accession should provide for: No. 1, the immediate elimination of tariffs on all U.S. distilled spirits; No 2., the adoption of internationally recognized product standards so that U.S.-produced rum and spirit-based coolers may be sold in Chile; and No. 3, the elimination of tax discrimination imposed on U.S. whiskeys under Chile's liquor tax system.

In addition, we also believe that Chile should be required to fully adhere to the applicable provisions of the NAFTA and to conform its domestic laws to those provisions as soon as possible.

Of particular importance to us is Chile's adherence to NAFTA's intellectual property chapter and to annex 313 of the NAFTA which provides for recognition and protection of bourbon and Tennessee whiskey as distinctive products of the United States.

Before concluding, I would like to explain why Chile's discriminatory liquor tax system is the most onerous barrier faced by U.S. distilled spirits companies. Under this system, bourbon and Tennessee whiskey are taxed at the rate of 70 percent of the duty-paid value.

Other U.S. distilled spirits, such as vodka and rum, are taxed at the rate of 30 percent. However, the rate of tax on pisco, the distilled spirit produced in Chile, is only 25 percent.

The significantly higher tax rate imposed on bourbon and Tennessee whiskey thus places these products out of reach for most Chilean customers. Given that whiskey is not produced in Chile, it is clear that the purpose of the tax system is to provide protection to domestic pisco producers. At this, it has been very successful.

In 1979 the rate of tax for whiskey was 30 percent, while pisco was taxed at 25 percent, with pisco holding 47 percent of the total market. Since then, the tax rate for whiskey has been progressively increased to 70 percent, while the pisco rate has remained unchanged.

The result has been that whiskey sales have fallen by more than 60 percent, while sales of pisco have nearly tripled. Today, as a result, pisco has 80 percent of the Chilean distilled spirits market. We hope this discriminatory tax treatment faced by U.S. whiskey will come to an end with the adoption of one single rate of taxation for all distilled spirits.

We look forward to working with you and the Congress for passage and accession of Chile to the NAFTA.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF FRED A. MEISTER
PRESIDENT AND CHIEF EXECUTIVE OFFICER
DISTILLED SPIRITS COUNCIL OF THE UNITED STATES

I am Fred A. Meister, President/CEO, of the Distilled Spirits Council of the United States, Inc. (DISCUS). DISCUS is the national trade association which represents U.S. producers, marketers and exporters of distilled spirits. Our members export to more than ninety countries worldwide, including Chile. DISCUS is pleased to have this opportunity to submit the following statement with regard to the negotiation of Chilean accession to the North American Free Trade Agreement (NAFTA).

I. DISCUS POSITION

DISCUS strongly supports the accession of Chile to the NAFTA. Chile's market oriented economic policies and recent record of sound economic performance make it the most appropriate candidate in Latin America for accession to the NAFTA. These policies have enabled Chile to escape the recent economic turmoil which has affected other countries in the region. Accession to the NAFTA at this time will buttress Chile's efforts to generate economic growth in the future and will strengthen its trade and investment ties with the United States.

Chile's accession to the NAFTA presents an excellent opportunity to secure enhanced access to the Chilean market for U.S. products. For U.S. distilled spirits exporters, it is an opportunity to build upon the small, but growing volume of sales in recent years, and to gain a competitive advantage for American spirits in the Chilean market place. With the U.S. market for distilled spirits in the midst of prolonged slump, expanding exports holds the key to the continued economic vitality of the U.S. distilled spirits industry. The increase in U.S. sales of distilled spirits which will result from the elimination of the import barriers currently maintained by Chile will generate additional production and jobs within the U.S. distilled spirits industry.

II. DISCUS OBJECTIVES

In general, Chile should be required to fully adhere to all the applicable provisions of the NAFTA and to conform its domestic laws to these provisions as soon as possible. Transition periods should be limited, both in time and in scope. As the U.S. market is already open to Chilean exports of distilled spirits, DISCUS strongly believes that the market access barriers currently faced by U.S. distilled spirits should be eliminated by Chile immediately upon accession to the NAFTA.

A. Tariffs

Chile currently applies tariffs of 11 percent ad valorem on imports of U.S. distilled spirits (classified in HTS heading 2208). Imports of distilled spirits from Chile currently enter the United States duty free under the U.S. Generalized System of Preferences (GSP) program (with the exception of minimal amounts of grape brandy, which are subject to MFN duty rates).

DISCUS urges the United States to negotiate on the basis of Chile's applied tariff rates and to insist upon the immediate elimination of these tariffs for all U.S. distilled spirits. DISCUS does not oppose the immediate elimination of the remaining U.S. tariffs on imports of distilled spirits from Chile.

B. Nontariff Barriers

1. Discriminatory Liquor Taxes

Chile maintains a discriminatory system of liquor taxation. Under this system, whisky is taxed at the rate of 70 percent of the duty paid value, while most other distilled spirits are taxed at the rate of 30 percent. However, the tax rate for pisco, the type of spirits produced domestically within Chile, is 25 percent. As whisky and most other distilled spirits are not produced domestically within Chile, this system of taxation severely penalizes imported products. Its sole purpose is to provide domestic producers of pisco protection from import competition.

The discriminatory treatment of imported spirits under Chile's tax system is a clear violation of the basic national treatment provisions of the NAFTA and the GATT. Indeed, in 1987, a GATT panel ruled that a similar system of taxation maintained by Japan violated GATT Article III (national treatment). The panel ruled that all distilled spirits are "directly competitive or substitutable products" and should be taxed in a like manner so as not to "afford protection to domestic production."

Accordingly, DISCUS urges the United States to insist that Chile fully adhere to the national treatment obligations of the NAFTA by eliminating the discriminatory tax treatment currently faced by U.S. distilled spirits, and adopting a single rate of tax for all distilled spirits, including pisco.

2. Product Standards

Under Chile's existing beverage law (Ministry of Agriculture No. 18.455 of 1985), no provision is made for low alcohol "coolers" containing distilled spirits. (The law does provide for wine-based coolers.) Consequently, imports of these products are not permitted. Chile's beverage alcohol law also contains an archaic definition of rum, which restricts the types of rum which can be sold on the Chilean market.

DISCUS urges the United States to press Chile to agree to adopt internationally recognized standards for these products. Such action is necessary in order to ensure that U.S. distilled spirits exporters can take advantage of the full range of commercial opportunities created by Chile's accession to the NAFTA.

3. Distinctive Products

Annex 313 of the NAFTA requires Mexico and Canada to recognize and protect Bourbon and Tennessee Whiskey as distinctive products of the United States. This provision ensures that only the genuine articles produced in the United States in accordance with U.S. regulations may be introduced for sale on the markets of the NAFTA parties as Bourbon or Tennessee Whiskey.

The recognition and protection of Bourbon and Tennessee Whiskey as distinctive products of the United States has been extremely valuable to U.S. producers in their efforts to develop foreign markets for these products. Accordingly, DISCUS urges the United States to insist that Chile assume the obligations of Annex 313 with respect to Bourbon and Tennessee Whiskey, with effect immediately upon accession to the NAFTA.

C. Intellectual Property

1. Protection of Trademarks and Copyrights

The NAFTA's chapter on intellectual property provides strong protection for trademarks and copyrights. This protection is of particular importance to U.S. distilled spirits companies, which rely heavily on trademarks and copyrighted materials to promote their branded products. Accordingly, DISCUS urges the United States to insist that Chile fully adhere to the provisions of the NAFTA with regard to the protection of intellectual property and to bring its domestic laws and regulations into full conformity with the NAFTA's provisions immediately upon accession.

2. Importation Rights

From the perspective of U.S. distilled spirits companies, the NAFTA's chapter on intellectual property is deficient in one key respect. It does not provide strengthened protection against the unauthorized importation or distribution of products protected by intellectual property rights. However, in approving the NAFTA implementing legislation and the accompanying Statement of Administrative Action, the Congress and the Administration made clear that the NAFTA "does not affect U.S. law or practices relating to parallel importation of products protected by intellectual property rights."

In the negotiations with Chile, DISCUS urges the United States to avoid undertaking any new obligation which would weaken in any way current U.S. law and practices with regard to parallel importation of products protected by intellectual property rights. It is essential to DISCUS and its member companies that they retain access to the full range of means currently available -- and preserved under the NAFTA -- to protect their intellectual property rights and enforce their territorial licensing arrangements for the distribution and sale of their products.

C. Other Issues

Distilled spirits are highly regulated at the both the federal and state level in the United States. Great care was taken in the negotiation of the NAFTA to ensure that its provisions did not supersede any of the laws and regulations enacted in the United States with regard to the distribution and sale of beverage alcohol products, including primary American source laws. In the negotiations with Chile, U.S. negotiators should avoid undertaking any new and additional obligations which would infringe upon these laws and regulations.

III. EXTENSION OF FAST TRACK AUTHORITY AND APPROVAL PROCEDURES

DISCUS strongly supports the early enactment by the Congress of legislation renewing fast track negotiating authority and approval procedures. Such authority and procedures are essential to the efforts of U.S. trade negotiators to forge new trade liberalizing agreements. Without this negotiating authority and accompanying approval procedures, U.S. negotiators will face an infinitely more difficult task in persuading our trading partners to open their markets to U.S. exports. Countries simply will not be willing to make concessions to the United States without the certain knowledge that the agreements entered into will not be amended in a subsequent negotiation with the Congress.

The success of the negotiations with Chile depends in large part upon the rapid renewal of fast track authority and procedures by the Congress. To date, much of the debate over fast track renewal has centered on whether or not labor and environment-related issues, including the use of trade sanctions, should be included in future trade agreements. While these issues are very important, we are deeply concerned that a prolonged debate on the merits of including these issues will result in a further delay in renewing fast track and the loss of the present opportunity to conclude a trade liberalizing agreement with Chile, which will benefit U.S. exporters. We urge the Congress to enact legislation renewing fast track as soon as possible in order to facilitate the successful conclusion of these negotiations.

IV. CONCLUSION

DISCUS strongly supported the original negotiation of the North American Free Trade Agreement and actively worked for its approval by the Congress. We support the accession of Chile to the NAFTA with the expectation that the terms of Chile's accession will provide for the elimination of the tariff and nontariff barriers presently confronting U.S. exports of distilled spirits to the Chilean market. We look forward to working closely with the Congress and the Administration to ensure that these issues are addressed satisfactorily so that U.S. distilled spirits companies may benefit from the expansion of the NAFTA to include Chile.

Thank you very much.

Chairman CRANE. Thank you, Mr. Meister.
Ms. Gleason.

STATEMENT OF CAROLYN B. GLEASON, LEGAL COUNSEL, CALIFORNIA CLING PEACH ADVISORY BOARD

Ms. GLEASON. Good afternoon, Mr. Chairman. I am Carolyn Gleason, here today in my capacity as counsel to the California Cling Peach Advisory Board, which is the entity that represents virtually all U.S. canned peach and fruit cocktail production.

There are some 20,000 growers, processors, and workers that comprise the industry. Virtually all of them will tell you that their industry can only lose by this agreement. They mean lose in every possible sense—they mean job displacement, significant market share loss, eroded profitability, even industry extinction.

There are four or five basic facts that have driven them to this conclusion. Fact No. 1, you have, with this industry, a sector that time and time again has been determined by the U.S. Government to be extraordinarily import sensitive, primarily a consequence of foreign unfair trading practices.

Since 1970 U.S. production of these items has dropped by 30 percent. Contrast that with our competition. In Chile you have production increases of some 220 percent; in Greece, 425 percent. Over the period our acreage has gone from 52,000 acres to 30,000 acres. Over the period our processors have dropped from 17 to 5. Over the period—and maybe this is the most disturbing of all—we have gone from being a very substantial net exporter of canned fruit to being a net importer.

All of these trends are a direct and immediate consequence of 15 successive years of massive global overproduction precipitated by unfair foreign trading practices. So fact No. 1, you have here a sector that is intensely vulnerable, through no fault of its own.

Fact No. 2, even with U.S. tariffs, which are reasonably high—they range from 17 to 19.5 percent—Chilean canned fruit already undersells California canned fruit by a full 20 percent or more. For a $15.50 case of canned peaches, their cost of production alone is $1.50 a case less than ours. You have heard about low labor rates, they have lower raw product prices. They have lower agricultural land costs. They also receive government rebates for another 50 cents to $1 a case price advantage.

Surprisingly, they have shipping rates about 30 percent lower than ours to the eastern seaboard, that is relative to our transport rates to the east coast.

So fact No. 2, the U.S. industry is already finding it exceedingly difficult to compete with Chilean products, even with present tariff rates.

Fact No. 3, Chile's canned fruit sector is expanding with a fury and that new output is being very specifically groomed and targeted for the U.S. market.

Chilean peach production has leapt 40 percent in the last year alone. They now have processing capacity sufficient to double overnight their exports to the U.S. market.

You can be assured that Chilean NAFTA negotiators are very well aware of these expansion efforts and have already notified

U.S. negotiators that one of their priority interests is immediate tariff elimination on these duty items.

Fact No. 4, all economists who have looked at this sector will tell you that increased imports from Chile will be exclusively at the expense of the California product. Their calculations show that a 50-percent rise in Chilean imports—and that is something that could happen very quickly—will reduce California revenues by close to $15 million with job losses numbering around 150.

With losses like that in a sector of this size you have to begin asking about the basic survivability of the industry.

Finally, fact No. 5, U.S. canned fruit processors have zero to gain from duty-free access to Chile. That is a market more than satisfied by local production. You see from these facts, alone, that for the California canned fruit industry, Chilean accession is strictly a lose-lose proposition. What we have said to U.S. negotiators is if you want to see this sector of American agriculture survive, please give us an exemption from tariff reductions. If that proves to be a negotiating impossibility, then, at a minimum, please give us a phaseout period materially longer than the 15-year maximum period you used in NAFTA.

I would like to close very quickly with a request made on behalf of all 20,000 individuals that comprise the industry. If you could, please include an instruction in your authority or report language to safeguard the interests of this sector by way of an exclusion or, at a minimum, by way of a super-NAFTA phaseout period.

Without this kind of safety feature, the California industry sees no possibility of surviving, in tact, this newest round of negotiations.

Thank you, Mr. Chairman.

[The prepared statement follows:]

BEFORE THE
SUBCOMMITTEE ON TRADE
OF THE
HOUSE COMMITTEE ON WAYS AND MEANS

ACCESSION OF CHILE TO THE
NORTH AMERICAN FREE TRADE AGREEMENT

WRITTEN SUBMISSION OF THE
CALIFORNIA CLING PEACH ADVISORY BOARD

I. Introduction

The following written comments regarding the proposed accession of Chile to the North American Free Trade Agreement (NAFTA) are submitted on behalf of the California Cling Peach Advisory Board (the "Board") in connection with the Subcommittee on Trade's June 21, 1995, hearing on Chile's accession to NAFTA. The Board's Washington, D.C. legal counsel, Carolyn B. Gleason, will testify on behalf of the Board at the June 21 hearing.

The Board is a non-profit quasi-governmental association representing all 750 cling peach producers and 5 cling peach processors in the State of California. Virtually all of the United States' cling peach production occurs in California. The Board's primary role is to assist the U.S. industry in the development of domestic and export markets for U.S. cling peaches. In this capacity, the Board actively represents the industry's interest in bilateral and multilateral trade negotiations. The Board was the industry's primary spokesperson during negotiations with Mexico on NAFTA and is continuing that role as negotiations with Chile get underway.

The U.S. cling peach industry is strongly opposed to a free trade agreement with Chile that would give Chilean cling peach exporters lower tariff access to the United States. More than most U.S. agricultural sectors, the California cling peach industry stands to be irreparably harmed if Chile is afforded more competitive access to the U.S. market. All indicators -- Chile's growing and competitive cling peach industry, the U.S. industry's demonstrable import-sensitivity, and Chile's lack of a domestic market for cling peaches -- make clear that a reduction or elimination of U.S. cling peach tariffs in favor of Chile will propel low-priced Chilean canned fruit into the U.S. market. With the U.S. market for canned peach products flat, and prices already at minimally sustainable levels, a surge in low-priced imports from Chile will cause substantial job displacement in California, severe erosion in U.S. grower and processor profitability, and ultimately threaten the survivability of the U.S. industry.

Because of this threat, the California cling peach industry is asking that canned peaches (H.S. 2007.00), fruit mixtures (H.S. 2009.92), and other cling peach products be *excluded* from tariff reduction negotiations. A full listing of cling peach products for which Chilean access is a concern, their H.S. numbers, and import-sensitivity levels is attached.

Chile, in other free trade arrangements, including its free trade agreement with Mexico, has favored the exclusion of import-sensitive items from tariff phase-out. That precedent should be adopted by the United States and Chile to cover manifestly import-

sensitive sectors like canned fruit. The U.S. industry urges the support of this Subcommittee for our industry's exclusion.

If Chile and the United States determine that sector-specific exemptions will not be allowed, the Subcommittee's support will be needed to ensure that our most sensitive products, as described in the attached listing, are designated as maximum import-sensitive products for tariff reduction purposes. For these products, the cling peach industry is asking for a tariff phase-out period significantly longer than the 15 years granted the most import-sensitive products under NAFTA.

II. The California Cling Peach Industry is Particularly Vulnerable to Imports of Low-Priced Chilean Canned Fruit. Because of This Import-Sensitivity, U.S. Tariffs Are Needed to Protect the U.S. Industry from a Surge in Low-Priced Chilean Canned Fruit Imports.

The import-sensitivity of California cling peaches has always been vigorously upheld by the U.S. government -- whether in the context of reviews under the Generalized System of Preferences, NAFTA, the Uruguay Round, or other bilateral matters involving canned fruit. The reasons are irrefutable: nearly two decades of domestic oversupply, little or no growth in U.S. consumer demand for canned fruit, growing competition and market access barriers in export markets, and growing U.S. imports of low-cost and often unfairly subsidized canned fruit from Greece, Chile, South Africa and elsewhere. For decades, California growers and processors have annually struggled to keep supply and demand in equilibrium.

A. Rapidly Expanding Global Cling Peach Production Has Forced the U.S. Cling Peach Industry Into Retraction.

Between the 1970's and early 1990's, U.S. production of canned cling peaches declined by 30%, while canned cling peach production in Greece and Chile rose by roughly 425% and 220%, respectively.

GLOBAL CANNED PEACH PRODUCTION
1,000 Cases 24/2½ Equivalent

	U.S.	% Increase	Greece	% Increase	Chile	% Increase	Others	% Increase	Total
1970-73	25,968		2,869		478		13,305		42,610
1990-93	18,197	(30%)	15,050	425%	1,512	220%	15,347	15%	50,106

Source: USDA/FAS Horticultural Products Review
U.S. data for 1990/93 from California Canning Peach Association, Almanac, 1994

In Greece alone over the last decade, production of raw cling peaches has soared from 170,000 metric tons in 1986 to 750,000 metric tons or more today, accounting for half of world production. This surge in production, encouraged by massive illegal processor and grower subsidies, has led to 15 successive years of global oversupply. With no such subsidies available to U.S. growers for their oversupply, California growers and processors have had no choice but to take radical measures to reduce production.

B. As U.S. Exports Have Fallen, Greece, Chile and Other Low-Cost Suppliers Have Significantly Increased Their Exports, Flooding the Global Market.

Canned peach exports have followed a similar pattern to global production trends. As U.S. exports dropped by nearly 70% between the early 1970's and 1990's, exports of Greek and Chilean canned peaches increased by as much as 10-fold. During this period the U.S. share of global exports fell from 22.7% to 4.2%, while Greece increased its export share from 10% to nearly 65%. Chile went from virtually no exports in 1970 to surpassing U.S. export volumes in the early 1990's.

GLOBAL CANNED PEACH EXPORTS 1,000 Cases 24/2½ Equivalent						
	U.S.	% Increase	Greece	% Increase	Chile	% Increase
1970-73	2,955		1,431		130	
1990-93	943	(70%)	14,309	900%	1,042	700%

Source: USDA/FAS Horticultural Products Review
U.S. data for 1990/93 from California Canning Peach Association, Almanac, 1994

The surge of low-priced, subsidized Greek exports onto the global market in the mid- to late 1980's forced California canned peaches out of the EU market (at one time the California industry's leading export outlet) and substantially displaced California product in Japan, Canada and elsewhere. More recently, Chile and South Africa -- with increasing exports of low-priced canned peaches -- have joined Greece in displacing U.S. product in global markets.

C. As U.S. Exports Declined, U.S. Imports Increased Sharply.

Despite relatively good U.S. tariff protection of 20% on canned peaches and 17.5% on fruit mixtures (19.5% and 17.1% respectively as of January 1, 1995, with the first Uruguay Round reduction), U.S. imports of canned perches increased significantly, from 23,000 cases in the early 1970's to up to 2 million cases in the 1990's. Today, U.S. imports exceed U.S. exports by an average of 200,000 cases per year.

D. With Global Canned Peach Production and Exports Increasing, the U.S. Industry Had No Choice But to Retrench.

Faced with massive global oversupply, increased U.S. imports, declining U.S. exports, and a declining U.S. consumer base, the California industry was forced into severe contraction and consolidation. Between the early 1970's and 1990's, the number of California canned peach processors declined from 17 to 5. Over the same period, acreage of cling peach production dropped from 52,000 acres to 30,000 acres as growers pulled out orchards to meet a smaller U.S. market. This year again, California growers have turned to a tree pull program to remove an additional 4,000 acres from production.

Self-help measures such as acreage reduction alone have not been enough to keep supplies in line with market demand. The U.S. industry has also relied on extensive U.S. government school lunch and other federal purchase programs to purchase excess supply and to help keep prices at minimally sustainable levels. Government purchases have been significant, averaging a million cases annually in the 1970's and 1980's. Although these purchases dropped by some 500,000 cases between the early 1980's and 1990's as the effects of industry tree pull programs kicked-in, over the last two years U.S. government purchases have again increased to over a million cases per year.

III. Chile is a Competitive Producer and Exporter of Canned Peaches and is Poised for Massive Expansion to the U.S. Market

A. Chilean Canned Peach Producers Enjoy Significant Cost Advantages Over California Producers.

Chile is among the lowest cost producers of canned peaches in the world. Largely because of low labor ($1.00 per hour), raw product, and agricultural land costs, Chile's cost of production for a standard case of peaches is roughly $1.50 less than the average cost of production for California processors.

Chilean canned peach processors also benefit from two forms of export rebates available under Chile's duty drawback system. One of the rebate programs pays processors for import duties paid on imported sugar and tin plate that are used as inputs

in canned peaches. These rebates, which are obtained upon export of the finished product, are believed to amount to a subsidy of $.50 a case. The other program is an automatic rebate of 10% of the FOB value of the finished product under Chile's "simplified duty drawback" system. Under the simplified duty drawback program, infant or non-traditional industries with total annual exports of less than $10 million qualify for an automatic rebate of 10% of the FOB value. Since total canned fruit mixture exports have been below the $10 million cap -- at $3.9 million in 1993 and $5.17 million in 1994 -- and the simplified duty drawback system requires very little administrative work on the part of the exporter, Chilean processors are believed to receive the rebate for almost all of their production.

Chilean exporters also have a competitive edge in the transportation cost advantages they enjoy over California shippers when sending product to east coast U.S. markets. Shipping rates from California to New York for a standard case of peaches are roughly one-third higher than rates from Chile to New York. These lower transportation rates are available to Chilean exporters because of the high frequency with which ships transporting large volumes of fresh fruit travel between Chile and the United States.

Chile's cost advantages are expected to increase as Chile's cling peach sector increases its production (see below) and Chilean processors become more efficient through economies of scale. Chile's raw product costs are expected to drop as orchard productivity is improved through the introduction of new California varieties (some of which were obtained illegally in violation of U.S. patents) and better production practices. Processing costs will also come down as improvements occur in converting raw product to finished product. This will be helped by Chile's production of new varieties developed in California that are more suitable for processing. All told, the Chilean industry's emerging advantages will result in an additional cost differential of $1.20 per case, for a total cost advantage of $3.20 per case. This nets to a 20% price advantage over the U.S. cling peach product cost of $15.25 to $15.65 per case.

B. The Chilean Cling Peach Industry is Anticipating Significant Expansion in the Near-Term -- Precisely Targeted for the U.S. Market.

The Chilean cling peach industry is engaged in aggressive measures to increase its canned peach production. Members of the Chilean industry's Federation of Chilean Food Processors and Agroindustrialists (FEDPACH) estimate that production of cling peaches in Chile will reach 96,800 tons by next year (1995/96), a 37% increase from last year's 70,500 ton crop. Even greater increases are projected for future years. Much of this new production will come from increased yields resulting from newer, more productive California varieties that are now coming on line. Some 80% of the new production is targeted for export, and most of that to the U.S. market in anticipation of preferential access.

U.S. industry and U.S. government representatives have seen first-hand these significant expansion efforts. Last year, when the Fruit and Vegetable ATAC Committee visited Chile, they saw the ample processing capacity and raw product availability Chile has to meet its increased production targets. They also observed abundant unused acreage in Chile that is planned for cling peach expansion. Based on these indicators and known technical improvements underway in Chile, experts estimate that Chile's production could easily double without a significant increase in orchard area.

On the processing side, Chilean plants are modern and significantly underutilized. ATAC members visited one plant that had capacity to double at will its current production from 15,000 metric tons to nearly 30,000 metric tons. That plant, which was built in 1993, is as modern as any processing plant in California.

Another factor influencing Chile's move to expand its canned fruit industry is the contraction of Chile's fresh fruit markets. As Chilean fresh fruit exports encounter accelerated competition in export markets and, thus, declining export prices, Chilean

producers are shifting more of their raw peach product to canned fruit production. The pervasive delays in fresh market consignment payments of up to 5 to 6 months has provided further incentive for growers to sell to the processing sector where the grower generally receives payment from the processor within 30 days of delivery of the raw product based on purchase contracts.

Chile's increased raw product availability and rapidly expanding capacity is already being targeted for the U.S. market. Chile now exports significant volumes of canned peaches to the U.S. market at prices $2 to $3 a case below California prices even paying the 19.5% U.S. duty. Any relaxation of this duty will provide additional impetus and advantage to Chilean processors to increase canned peach production exclusively for the U.S. market.

IV. Increased U.S. Imports From Chile Will Wreak Havoc on an Already Mature and Oversupplied U.S. Market.

With U.S. consumer demand for canned peaches stable at best and U.S. processors already losing sales to lower-priced Greek and Chilean product, any increase in imports from Chile will be at the direct and immediate expense of California processors and growers. Substantial jobs will be lost and U.S. grower and processor profitability severely eroded.

Price/purchase relationship data on canned peaches show that in the mature U.S. market, imports of low-priced Chilean canned peaches will cause the U.S. market price for canned peaches to drop, but without a corresponding increase in consumer demand for peaches. With no market expansion, lower-priced imports will net a one-for-one displacement of higher-priced California canned peaches. The higher quality of California product and U.S. brand recognition will have little if any effect on salvaging this displacement. In part, this is because a large percentage of canned peach and fruit mixture sales are sold to the institutional and food service sector where brand loyalty means little and price alone is the controlling purchasing factor.

Economists estimate that U.S. grower and processor revenues will decline in direct proportion to increased Chilean imports. For example, it has been calculated that a 50% increase in Chilean imports will displace some 625,000 cases of U.S. canned peaches, causing grower revenues to decline by some $2.5 million and U.S. processor revenues to drop by $10 million.

The same 50% increase in Chilean imports will mean a loss of over 135 full-time equivalent jobs in the processing sector and allied and related job sectors. Any further contraction of the U.S. industry will threaten the viability of the industry and put at risk thousands of industry and allied sector jobs. The effect would be devastating to California, given the concentration of the cling peach industry in that state.

V. The U.S. Cling Peach Industry Will Gain Nothing From Duty Free Access to Chile Since Market Opportunities Are Nil.

Chile has only a small domestic market for canned fruit, and then only for low quality, lower-priced product. It is for this very reason that Chile exports roughly 90% of its canned fruit production.

Chile's small domestic demand for canned fruit can easily be supplied by its own canned fruit industry. Any advantage U.S. processors have over their Chilean competitors because of quality, are not enough to overcome the significant price advantage enjoyed by Chilean processors in their own domestic market.

Because the U.S. cling peach industry has never exported to Chile and has no expectation of doing so in the future, even with duty free access, the industry has not researched and is thus unaware of nontariff barriers that might affect imports of canned

fruit. Chile imposes an 11% tariff on imports of canned peaches, fruit mixtures, and other cling peach products of interest. Since there is no market to be had, the elimination of these duties will have no positive effect on California canned fruit exports to Chile.

VI. Conclusion

Over the past two decades the California cling peach industry has been successful in keeping its tariff protection despite efforts from foreign producers to gain GSP-eligibility or to gain tariff cuts through multilateral or bilateral trade negotiations. A free trade agreement with Chile, however, poses our industry's greatest threat to date. The viability of the California industry depends on continued good efforts by the U.S. government to maintain U.S. cling peach tariffs in the forthcoming negotiations with Chile. The industry urges this Subcommittee to actively support these efforts.

As tariff negotiations begin, we ask the Subcommittee to remind U.S. negotiators of the cling peach industry's struggle with subsidized competition, oversupply, increased imports and declining exports. Our first preference is for cling peach products to be excluded from tariff reductions. If this is not possible, at a minimum, the industry needs assurances that it will be protected by maximum tariff phase-out periods for its products. These phase-out periods must be substantially longer than the 15-year period determined for import-sensitive items under NAFTA. We urgently request the Subcommittee's assistance in achieving these results.

Attachment

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MARKET ACCESS NEGOTIATIONS WITH CHILE

U.S. H.S. Number	Product Description	U.S. Tariff*	Export Priority			Import Sensitive		
			H	M	L	H	M	L
2008.70.00	Canned peaches (i.e., prepared or preserved peaches)	19.5%				X		
2008.92.90	Canned fruit mixtures (i.e., prepared or preserved fruit mixtures, including peaches)	17.1%				X		
2008.70.00	Peach concentrate (i.e., peach pulp)	19.5%				X		
0811.90.80.80	Frozen peaches	16.6%				X		
2008.40.00	Canned pears	17.6%				X		
2008.92.10	Canned tropical fruit mixtures	6.8%				X		
2009.80.60	Peach juice	0.8¢/liter* GSP Free				X		
2007.10.00	Homogenized fruit preparations (covering peach baby food)	14.5%					X	
2007.99.35	Peach jam	7%					X	
2008.50.40	Apricots, otherwise prepared or preserve (covering canned apricots)	34.1%					X	
2008.99.42	Nectarines, otherwise prepared or preserved (covering canned nectarines)	19.3%					X	
2007.99.65	Other fruit pastes and purees (covering peach paste and puree)	12.1%					X	
0809.30.20 0809.30.40	Fresh Peaches If entered 6/1-11/30 If entered 12/1-5/31	0.4¢/kg. Free						X
2007.99.75	Fruit jellies, other (covering peach jelly)	6.4%* GSP Free						X
2206.00.90	Other fermented beverages (covering peach coolers)	6.2¢/liter* GSP Free						X
2202.10.00	Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavored (covering peach flavored mineral water)	0.3¢/liter* GSP Free						X

* GSP-eligible.

Chairman CRANE. Thank you, Ms. Gleason.

I want to thank all three of you for your patience, your testimony, and reassure you that your entire written statements will be made a part of the record.

With that, finally, the subcommittee is adjourned.

[Whereupon, at 4:42 p.m. the hearing was adjourned.]

[Submissions for the record follow:]

SUBMITTED STATEMENT OF MARK A. ANDERSON, DIRECTOR
AFL-CIO TASK FORCE ON TRADE
ON BEHALF OF THE
LABOR ADVISORY COMMITTEE FOR TRADE NEGOTIATIONS AND TRADE POLICY
TO THE SUBCOMMITTEE ON TRADE OF THE
COMMITTEE ON WAYS AND MEANS
ON
ACCESSION OF CHILE TO THE NORTH AMERICAN FREE TRADE AGREEMENT

June 21, 1995

On December 11, 1994, the heads of State of the United States, Mexico, Canada, and Chile announced their decision to begin the process by which Chile will accede to NAFTA. In that announcement, they stated "We seek in this hemisphere to expand market opportunities through equitable rules and to eliminate barriers to trade and investment through agreed disciplines at high levels. This approach, coupled with policies that address the conditions of labor and protection of the environment will be pillars of a new partnership in the Americas." Formal negotiations are expected to begin in the spring of 1995.

The AFL-CIO and the Unitarian Workers Central (CUT) of Chile had advocated the negotiation of a bilateral trade agreement to make it more likely that basic worker rights and standards were included directly in an agreement, and subject to the same dispute settlement mechanism available to rules governing capital. While recognizing that the NAFTA represented a small first step in addressing workers interests, workers in both the U.S. and Chile did not want the flawed labor side agreement to NAFTA to be the standard for further hemispheric integration.

In commenting on the announcement of negotiations leading to Chilean accession to NAFTA, the AFL-CIO and the CUT stated that they "deeply regret the decision of our two governments to negotiate a new trade arrangement through the expansion of the flawed NAFTA. We have argued for months for a bilateral agreement which would set new standards for decency in trade matters in a way that the interests of the companies should not be above the internationally recognized labor rights of the workers... We will nevertheless continue to work together to make respect for basic worker rights and standards a central feature of trade agreements in this hemisphere."

While negotiations with Chile over NAFTA accession will make this goal more difficult to achieve, it remains eminently possible, and should be the principal negotiating objective of the U.S. The government of Chile has expressed its willingness to discuss these questions. The opportunity to secure the support of workers, who are most at risk from trade openings should not be squandered by governments. Addressing their interests would clearly demonstrate that movement toward freer trade can be beneficial to the majority of people and not just corporate and political elites.

Events following the enactment of NAFTA, demonstrated that the agreement, as written, provided no guarantee or assurance of economic prosperity. Indeed, the reverse is painfully evident. The financial crisis in Mexico that has resulted in a massive devaluation of the peso will cause untold hardship for tens of thousands of Mexican and U.S. workers. In Mexico, workers have seen their real earnings plummet, while multinational corporations have reaped a financial windfall from drastically lower dollar denominated wage costs. U.S. workers will see their jobs

disappear as Mexico cuts imports, promotes exports, and seeks to attract more and more U.S. investment. The small U.S. trade surplus in 1994 will turn into a deficit that may reach $15 billion in 1995. Clearly, NAFTA is not the answer. Negotiations with Chile provide the opportunity to make necessary improvements and reduce the likelihood of the Mexican tragedy being repeated.

LABOR RIGHTS AND STANDARDS

The linking of labor rights and standards to trade has been a long held, but unfulfilled, bipartisan negotiating objective of successive U.S. administrations. Both the 1974 and the 1988 Trade Acts made worker rights a principal trade negotiating objective of the U.S. Labor rights conditionality has been established in a variety of U.S. trade laws, among them the Caribbean Basin Initiative in 1983, the Generalized System of Preferences in 1984, Overseas Private Investment Corporation in 1985, Section 301 of the 1988 Trade Act, and most recently in the 1994 authorization bill for multilateral lending organizations. That conditionality must be extended to NAFTA through the upcoming negotiations with Chile. Failure would be a step backward in this vital area.

This linkage has been based on the understanding that there are no automatic mechanisms by which increased trade or indeed, purely national economic growth, leads to higher wages and improved working conditions. While increased trade can provide the resources for improvements, history tells us that only trade unions through collective bargaining and government through adequately enforced labor laws can insure that increased trade really does lead to higher standards of living for all workers.

As a rules-based international trading system develops, it is vital that workers receive the same treatment that has been provided business interests. These rules are, in large measure, designed to establish basic conditions under which traded goods and services are produced. No longer are they focused solely on border measures, but now address practices that heretofore were considered purely domestic in nature. For example, the provision of financial services, domestic government subsidies, consumer and product standards, anti-competitive practices are all subject to international discipline or discussion. If it is possible to reach agreement on issues as complex as intellectual property protection, whose direct link to trade is tenuous at best, surely it is possible to negotiate basic rules for worker rights and standards that are directly related to the production process.

While the North American Agreement on Labor Cooperation represents a small first step in associating worker rights and standards to an international trade agreement, major improvements are needed. The AFL-CIO believes that at minimum, negotiations should focus on reaching agreement concerning the prohibition of forced labor, guarantees on freedom of association and the right to organize and bargain collectively, as well as nondiscrimination in employment. Negotiations should also seek to delineate rules and regulations that insure a safe and healthy workplace, prevent child labor and establish appropriate standards concerning hours of work. An international consensus on these issues and others has already been developed by the International Labor Organization.

Agreements reached in these areas should be incorporated in the main body of trade agreements, and be subject to the same dispute mechanisms available to other covered issues. During a period of increasing economic uncertainty, workers interests can no longer be shunted aside to inadequate side agreements.

FINANCIAL SERVICES, INVESTMENT, AND CAPITAL MARKETS

A central thrust of NAFTA was the reduction or elimination of governmental control over the provision of financial services, capital flows, and investment. What was ignored is the reality that when governments stop regulating or supervising trade, currency, and investment flows, then those matters will be the sole province of private investors, multinational corporations and currency speculators. They, not elected governments, will make decisions affecting economic development and equity, and thus democracy itself.

The financial crisis in Mexico, and its harm to Mexican and U.S. workers is a grim reminder of the folly of relying solely on the "market" as a means to achieve economic prosperity. Ironically, speculators will be protected from the market by U.S. government intervention, but workers in both countries have been simply told to submit to the discipline of market forces. During the NAFTA negotiations, the LAC repeatedly urged that the governments address such issues as excessive foreign debt, exchange rate fluctuations, and investment controls and oversight. That advice was ignored.

The upcoming negotiations provide the opportunity to learn from past mistakes and develop alternative approaches to the important issue of capital markets. U.S. taxpayers should no longer be required to be the ultimate rescuer of speculators and elites involved in ill conceived economic activity. Among the issues that should be positively addressed are greater transparency, a transaction tax on short term financial instruments, expansion of such laws as Chile's that prohibit the repatriation of capital for one year, expansion of government screening of inward investment, increases in reserve requirements for financial institutions, as well as direct negotiations on exchange rates.

INTELLECTUAL PROPERTY

There are a variety of issues concerning the rights of performers that need to be addressed in the upcoming negotiation. They include the following:

* A new NAFTA agreement, as is now the case with the WTO, should require that parties to the agreement provide performers with the ability to prohibit the unauthorized fixation, reproduction, or broadcast of their live performances.

* Negotiations must develop provisions, based on existing U.S. law, that obligates audio hardware manufacturers and blank tape suppliers to pay a levy to compensate copyright owners and performers for unauthorized home copying. The revenue collected from this levy is distributed to performers and copyright holders on the basis of national treatment. U.S. statute also prohibits the sale or importation of audio

hardware that is not equipped with technology that prevents serial digital copying. Similar protections should be included in NAFTA.

* Legislation is now being considered by Congress that would give copyright owners the ability to authorize or prohibit the transmission of their sound recordings through digital media. This kind of protection is necessary for performers and must be included in a new agreement, and should be extended to all audio/visual works.

* The existing NAFTA, denies American performers, but not producers, the right to collect revenue for the public performance of their sound recordings. This inequity must be corrected in the upcoming negotiation, and should be extended to all audio/visual works.

* Finally, the existing NAFTA exempts Canada from appropriate obligations for its "cultural industries." This exception has been particularly harmful to the U.S. entertainment industry, is currently subject to a Section 301 petition, and has been cited by France, the European Union, and other countries as the basis for exempting their cultural industries from WTO discipline. It must not be extended to other nations.

TEMPORARY ENTRY

The existing NAFTA, as well as its predecessor, the U.S.-Canada FTA, made significant changes in U.S. immigration laws by expanding the right of U.S. employers to recruit foreign nationals to work in the United States on temporary status in professional occupations. Employers are not required to obtain a visa or demonstrate that a shortage exists.

The impact of these provisions is most acute in the health care industry. Because the FTA provisions were enacted on top of the H-1A visa program which was enacted in 1989, the annual entry of temporary RN's now equals some 5 percent of RN's newly diplomaed in the United States each year who are looking for work. Instead of cutting back on their use of temporary RN's as the shortage of the 1980's abated, employers have continued to increase their use. This is especially troublesome in light of the fact that the health care industry is undergoing a massive and far-reaching restructuring. The maximum cooperation of government, employers and workers will be needed to promote the retraining and re-employment of displaced workers. The continued existence of this free trade loophole--which is being expanded through inter-governmental consultations to include additional health care occupations--only makes that cooperative effort more difficult to achieve.

The LAC believes that NAFTA provisions permitting this type of entry should be renegotiated in order to remove registered nurses and other health care professionals from the list of eligible occupations.

SAFEGUARDS

The existing NAFTA seriously weakened Sec. 201 of the Trade Act by drastically limiting the ability of the government to impose protective measures, including quotas, to remedy or prevent injury to domestic industry and to workers as a result of increased imports from the other parties. While providing the illusion of possible safeguard action, the present agreement includes procedures and definitions that make the finding of injury highly unlikely, while at the same time prohibiting the imposition of measures that would remedy injury caused by imports.

The deficiencies of this chapter loom large in light of the Mexican financial crisis and peso devaluation which help will turn the small 1994 U.S. trade surplus with Mexico into a deficit that may reach $15 billion by the end of 1995. That shift in terms of trade between Mexico and the U.S. will result in the displacement of tens of thousands of U.S. workers because they have little hope of receiving relief from U.S. trade law. The LAC believes that this chapter should be renegotiated to correct its serious shortcomings.

MARITIME TRANSPORTATION SERVICES

The existing NAFTA exclusion for maritime transportation services must be preserved in its entirety. As has been demonstrated historically, and most recently during the 1990 allied intervention in the Persian Gulf, the U.S.-flag maritime industry plays an essential role in the nation's economic and sealift security. In recognition of the vital need to maintain forward projection of military forces, Congress and the Administration have supported exclusion of maritime services from international trade negotiations. The AFL-CIO endorses this action and urges that

any new agreement maintain the exclusion contained in the U.S.-Canada Free Trade Agreement and NAFTA.

ENVIRONMENT

The Declaration of Principles adopted by the Heads of State at the Summit of the Americas stated that, "Social progress and economic prosperity can be sustained only if our people live in a healthy environment and our ecosystems and natural resources are managed carefully and responsibly." Negotiations with Chile provide the first opportunity to take concrete steps to bring life to that Summit declaration.

The LAC believes that the environmental side agreement to NAFTA, while establishing a connection between necessary environmental protection and commercial agreements, is inadequate to the task of insuring progress in this important area, and should be significantly improved. Appropriate environmental law, and the means to fairly and openly settle disputes concerning those laws, should be made part of any new trade agreement.

NAFTA TRANSITIONAL ADJUSTMENT ASSISTANCE PROGRAM

The NAFTA-TAA Program was established to provide training, re-employment services and income support for workers dislocated because of trade with Mexico and Canada. As of April 10, 1995, the Department of Labor had received 426 petitions requesting assistance. Of that number, 194 were certified, covering almost 27,000 workers who lost his or her job because of NAFTA. With the U.S. trade balance deteriorating sharply with Mexico and Canada, the need for effective

adjustment assistance will grow rapidly. The addition of Chile to NAFTA will add to this serious problem.

The LAC believes that NAFTA-TAA needs to be improved by increasing public outreach efforts on the part of government, relaxing the very strict training requirements currently present in the program, increasing program coverage to include service workers, and extending the income support component of the program to two years. Such steps would ease the burden on those workers whose jobs disappear because of NAFTA.

STATEMENT OF
THE AMERICAN FOREST & PAPER ASSOCIATION

SUBCOMMITTEE ON TRADE
WAYS AND MEANS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

CHILE NAFTA ACCESSION

AF&PA is the national trade association of the forest, pulp, paper, paperboard, and wood products industry. AF&PA represents approximately 400 member companies and related trade associations (whose memberships are in the thousands) which grow, harvest and process wood and wood fiber; manufacture pulp, paper and paperboard products from both virgin and recovered fiber; and produce solid wood products.

The vital national industry which AF&PA represents accounts for over 7 percent of total United States manufacturing output. Employing approximately 1.6 million people, the forest products industry ranks among the top 10 manufacturing employers in 46 states, with an annual payroll of approximately $49 billion. Total forest products industry sales exceed $200 billion annually with exports accounting for $18.4 billion.

AF&PA supports in principle Chilean accession to NAFTA. However, we wish to draw attention to two overarching issues.

- AF&PA opposes extension to Chile of the NAFTA side agreements on labor and environment. The side agreements with Mexico and Canada represent a specific response to the unique environmental and labor market circumstances associated with a common border. U.S. negotiating objectives in the case of Chile should be limited to the expansion of U.S. commercial opportunities and specifically should not include the kind of environmental or labor policy linkages which could ultimately serve to inhibit trade between our countries.

- In the forest products sector, Chile must be measured against the standard which would be applied to a developed country producer. As detailed in the attachment to this statement, Chile is a world class supplier of certain paper and wood products. At the same time, it has attracted significant third country (principally Japanese) investment in this sector. For this reason, an accelerated pace of tariff reduction, to be substantially completed in year one, is absolutely required to prevent major disruption in regional paper and wood product markets attendant on Chilean accession.

AF&PA believes Chile must meet the following conditions in the forest products sector as part of its NAFTA accession:

- Agree to bind immediately its tariffs on all products of Chapters 44, 47 and 48 at the currently applied 11 percent rate.

- Upon accession, cut tariffs on all products of Chapters 44, 47 and 48 to zero. In no case should staging be permitted to extend beyond three years.

- Upon accession, eliminate subsidies to the forest products sector, especially upstream subsidies which underwrite timber supply for a growing export industry.

- Upon accession, eliminate all customs practices that treat domestically produced products more favorably than foreign products.

Tariffs

All Chilean imports of wood, pulp and paper products are subject to an 11 percent tariff (the Uruguay Round bound tariff rate is 25 percent). While this rate also applies to Chilean imports from our major competitors, the Nordic countries, these countries have a significant ocean freight cost advantage over U.S. suppliers, which may in part be derived from subsidies to Nordic ocean carriers.

In the past, Chile has cut import barriers to a greater extent than its South American neighbors. In view of the developed status of the forest products industry in Chile, however, a special case can be made for more substantial cuts in barriers affecting forest products imports. The complete elimination of tariffs in the already internationally competitive Chilean forest products sector will provide added impetus to future growth and greater economic efficiency in this sector. Tariffs on all products in Chapters 44, 47 and 48 should be eliminated immediately upon accession. In no case should staging be permitted to extend beyond three years.

The elimination of Chile's tariffs would put U.S.-Chilean market access on equal footing since that country's wood and paper products have enjoyed free access to the U.S. market because Chile is a GSP beneficiary.

Subsidies

Chile subsidizes much of the costs of planting, trimming and managing the planted forests that essentially underwrite the wood raw material base of Chile's forest industry. These subsidies, which are provided pursuant to Decree Law Number 701, have amounted to more than $120 million since 1974 and were due to expire in March 1995, but the Government of Chile has announced its intention to extend them until March 1996. The impact of DL-701 on radiata pine plantings can be seen from observing the age of tree farm plantations. Over 85 percent of Chilean radiata pine tree farms are less than 15 years old.

We recognize that government incentives have often been employed when a country initiates programs to improve its forests and to expand national wood and fiber self-sufficiency. This was the case, to some extent, in the United States at the inception of forestry here. However, those subsidies then normally diminish substantially except for modest incentives for specific, limited objectives. Chile's subsidies, however, were developed to directly support an export industry, and not for domestic conservation purposes. While we have no direct evidence, we suspect that this export sector has also benefitted from other Chilean government financial incentives based on the fact the industry was targeted for growth by the government.

AF&PA believes that broad government subsidies that essentially underwrite the wood raw material base of Chile's forest products export industry are unacceptable and should be discontinued on Chilean entry into NAFTA. The premise of NAFTA is open market competition without tariff or subsidy distortions, and Chile's current degree of timber supply subsidy is inconsistent with that premise.

Customs Practices

We understand that Chilean Customs provides a 10 percent "drawback" to exporters on packaging which is produced from locally-manufactured linerboard. In contrast, Chilean exporters using packaging made from U.S. supplied linerboard receive only a 5 percent drawback. This practice discriminates against U.S. suppliers and should be eliminated immediately.

In summary, Chile has a dynamic and internationally competitive forest products industry that does not require the continuing protection of high tariffs or the kind of government financial support provided under Decree Law Number 701. To advance the U.S. objective of liberalized trade in the hemisphere, any NAFTA agreement with Chile must provide for the immediate elimination of tariff and non-tariff barriers which protect its forest products market. A failure to achieve these objectives in the case of Chile will set an unfavorable precedent for negotiation of NAFTA accession with other Latin American countries which generally have far more restrictive tariff and non-tariff barriers.

Thank you for your consideration of our comments.

Attachments

CHILE.TES

CHILE'S FOREST PRODUCTS SECTOR

Attachment to
Statement of the American Forest & Paper Association

While market growth is constrained by Chile's small population, the Chilean economy has posted some of the best growth rates in Latin America in the past decade. The country possesses one of the world's fastest growing forest products sectors with a major export component.

Forest Resources. Chile has 1.1 billion cubic meters of available forest resources. Based on current and proposed plantings, Chile's commercial tree volume should double over the next 20 years. More than 90 percent of Chile's industrial wood comes from plantations. These are predominantly fast growing radiata pine, but eucalyptus is becoming increasingly important. The forest products industry is the second most important export sector in the Chilean economy -- trailing only mining -- and accounts for 13 percent of Chile's export earnings.

Solid Wood Products. Chile's 1993 exports of wood products are estimated at $671 million. These exports are expected to grow, benefitting from increasing environmental constraints on production in several countries. Wood chips, sawnwood, and roundwood logs are the most important wood product exports from Chile. The U.S. is a significant market for Chile, importing $124 million of Chilean wood products -- mostly softwood lumber -- in 1994. One of Chile's largest forest products companies reportedly plans to build six large sawmills in the next several years, significantly expanding its lumber export business.

While the total amount of U.S. solid wood exports to Chile is quite small (1994 exports of $5.7 million) because of sufficient domestic supply and the high transportation costs to Chile, there is increased demand for high-quality wood products for the construction industry. Demand is highest in Chile's northern region, where imported wood products can compete more easily with domestic products because of the significant transportation costs associated with shipping from the growing area in Chile's south.

Pulp. Overall, Chile vies with Brazil and Indonesia as the world's lowest cost wood pulp producer. In 1993, Chile was the world's 13th largest producer of pulp. Production reached 1,864,000 metric tons (m.t.), of which over 75 percent was exported. Current industry plans call for a significant expansion of export-directed wood pulp capacity by early in the next decade. In 1994, U.S. purchases of Chilean wood pulp amounted to 72,105 m.t. While this amount represents a small portion of the country's total wood pulp exports, there are reports that Chilean pulp producers are planning to expand their business in the U.S. market.

Paper and Paperboard. Chile's paper and paperboard sector is relatively small, with production of 528,000 m.t. in 1993. Consumption that year amounted to 536,000 m.t. With per capita paper and paperboard consumption of about 40 kilograms, the potential for growth is very significant. (By comparison, per capita consumption in South Korea, another emerging market, is about 127 kilograms.)

Newsprint accounted for 35 percent of production; printing and writing paper 17 percent; and corrugating materials 17 percent. Chile exported 143,000 m.t. of newsprint -- 77.3 percent of total production. Imports of paper and paperboard totaled 162,000 m.t., of which 48 percent was printing and writing paper and 41 percent linerboard, (primarily used in the manufacture of corrugated boxes used to export fruit and vegetables).

The U.S. exported $57.8 million (100,113 m.t.) of paper and paperboard products to Chile in 1994, up from $43.8 million (78,243 m.t.) in 1993. 1994 exports consisted primarily of unbleached kraft linerboard, semi-chemical fluting paper and newsprint. In 1993, the U.S. accounted for approximately 48 percent (tonnage basis) of Chile's import market for paper and paperboard. The U.S. does not import significant quantities of paper and paperboard from Chile.

The attached tables show U.S. exports of wood and paper products to Chile.

Attachments

CHILE.TES

U.S. Paper Industry Exports to Chile

Values in Thousands of U.S.$

Product	1994 Value	1994 Metric Tons	1993 Value	1993 Metric Tons
Wood Pulp	1,723	3,377	427	1,087
Cotton and Other Pulp	1,087	2,845	84	127
Recovered Paper	10	75	0	0
Paper Total	14,338	17,847	10,695	8,879
Newsprint	4,784	10,165	2,625	3,087
Printing and Writing	5,940	5,423	5,452	4,733
Paperboard Total	26,911	68,103	22,142	61,230
Kraft Linerboard	17,578	45,183	15,991	47,432
Semi-Chemical Corrugating Medium	5,569	15,669	3,314	10,755
Converted Products	13,750	7,866	10,494	6,920
Total	57,819	100,113	43,842	78,243

Source: U.S. Bureau of Census

July 1995
AF&PA International Department

U.S. Solid Wood Products Exports to Chile

Values in Thousands of U.S.$

Product	1994 Value	1994 Quantity	1993 Value	1993 Quantity
Softwood Lumber	642	1,966 cum*	324	2,037 cum*
Fabricated Structure	368	na**	18	na**
Hardwood Veneer	344	300,706 units	456	398,041 units
Hardboard Quantity	321	430 cum*	53	152 cum*
Hardwood Lumber	150	332 cum*	56	106 cum*
Total Solid Wood Products	5,714	na**	4,353	na**

* cum = cubic meters

** na = not available

Source: U.S. Department of Agriculture, Foreign Agriculture Service

July 1995

AF&PA International Department

STATEMENT OF AMERICAN TEXTILE MANUFACTURERS INSTITUTE

This statement is submitted by Executive Vice President Carlos Moore of the American Textile Manufacturers Institute (ATMI), the national association of the textile mill products industry. ATMI's member companies are engaged in every facet of textile manufacturing and marketing. They range in size from small, family-owned enterprises with one producing facility and a few score employees to publicly-owned billion dollar corporations with thousands of workers. Collectively they account for about eighty percent of fiber consumption by U.S. textile mills.

ATMI supports the concept of western hemispheric free trade based on NAFTA principles as a way to promote free trade among countries committed to fair and reciprocal trade. Specifically with regard to Chile, and based on our understanding of the current situation, we believe that Chile has qualified to assume the responsibilities of NAFTA membership and that there are no reasons why it should be denied this opportunity.

At the same time, ATMI believes that Chile's accession to NAFTA must depend upon certain important conditions being met, as follows:

1. The agreement must include NAFTA's rules of origin for textile and apparel products;

2. There should be no tariff preference level's (TPLs) in the agreement without a clear demonstration of their need (i.e., there should be no blanket or discretionary authority for granting TPLs);

3. The agreement should provide for a completely reciprocal phaseout of Chilean and U.S. tariffs on textile and apparel exports between the two countries;

4. As Mexico and Canada have already done, the government of Chile must agree to provide intellectual property protection for textile and apparel designs, trademarks, models, etc.; such protection must be equivalent to that provided by the other NAFTA partners;

5. There should be a safeguard provision in the agreement for the U.S. to use against disruptive imports not meeting the rules of origin requirement; and,

6. Chile should agree to effective customs enforcement measures, including unrestricted access, as Mexico and Canada have already done, to U.S. Customs Service "jump teams" which police against transshipment of non-originating textile and apparel products.

Much as ATMI supported NAFTA and much as we support the proposal to grant NAFTA parity to CBI beneficiary nations with the same strong rules of origin and customs enforcement requirements, we look forward to the increased trade opportunities which will ensue from Chile's accession to NAFTA once these criteria are met.

SUMMARY

ATMI supports Chile's accession to the North American Free Trade Agreement (NAFTA) provided that the terms of its accession meet certain conditions. Those conditions include. incorporation of NAFTA's rules of origin for textile and apparel products; NAFTA provisions for Customs enforcement; strict limits on grants of authority for tariff preference level's (TPLs); reciprocal phaseout of textile and apparel tariffs; NAFTA-comparable intellectual property protection for textile and apparel products; and a safeguard provision for the U.S. to use against disruptive imports which do not meet the rules of origin requirement. If it is structured in this way, ATMI believes an agreement to allow Chile's accession to NAFTA would provide increased export opportunities for U.S. textile mills and would promote hemispheric free trade to the benefit of all participants.

For the American Textile Manufacturers Institute
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STATEMENT OF JERRY R. JUNKINS CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER OF TEXAS INSTRUMENTS INC. ON BEHALF OF THE BUSINESS ROUNDTABLE REGARDING ACCESSION OF CHILE TO THE NORTH AMERICAN FREE TRADE AGREEMENT

SUBMITTED TO THE HOUSE COMMITTEE ON WAYS AND MEANS

I am pleased to offer these comments on behalf of The Business Roundtable on U.S. negotiations with Chile towards its accession to the North American Free Trade Agreement (NAFTA). The Business Roundtable is an association of some 200 chief executive officers who examine public issues that affect the economy and develop positions that seek to reflect sound economic and social principles.

Chile Represents Important Opportunities for U.S. Companies and Their Workers

Chile is one of the key economic success stories in Latin America, with GDP growth averaging 6.4% a year from 1983-1993, and per capita income rising an annual average of 3.9%, the highest rates in the region. In the meantime, inflation seems to be under control; in fact, Chile has had the lowest annual rate of inflation of any major Latin American economy for the ten years through 1993. Chile's currency and stock markets have been basically stable in recent years. In addition, Chile has made a smooth transition to democratic, civilian rule.

Chile has also been a leader in the trend toward open markets in Latin America. In the past few decades, Chile has taken significant steps to opening up its markets to foreign goods and services and to foreign investment. It has reached trade agreements with Mexico, Colombia, and Venezuela. It has also reached agreement with the Southern Cone Common Market, Mercosur (consisting of Brazil, Argentina, Paraguay, and Uruguay), to develop a free-trade area by the year 2000.

As a rapidly developing economy, the Chilean market presents new opportunities for U.S. companies and their workers. Major projects are underway or planned in many infrastructure areas, including environment, transportation, and telecommunications. These should present important opportunities for U.S. providers of goods and services. The United States is already Chile's largest trade partner, accounting for 23% of its imports in 1993. U.S. exports to Chile increased 7% from 1993 to 1994, and more than tripled between 1987 and 1993.

The United States Should Actively Pursue Free Trade Negotiations with Chile

While it has made significant progress, Chile still maintains barriers to trade and investment that harm, or threaten to harm, U.S. companies and their workers. For example, Chile discriminates against some agricultural imports; its intellectual property laws, while good, do not yet offer adequate and effective protection; it still imposes some restrictions on foreign investment; and its "luxury" taxes operate to discriminate against some imported goods.

Because of the opportunities the Chilean economy presents, and the need for further market liberalization in Chile, The Business Roundtable strongly supports free trade negotiations with Chile. Besides the immediate gains U.S. companies and workers will see from Chilean liberalization, Chile represents an important chance for the United States to extend a mutually beneficial set of trade and investment rules into South America.

The United States cannot ignore the need to expand free markets, along the NAFTA model, further into Latin America. We must do so quickly, as Latin American countries will not wait for us. Intra-regional trade has already risen from 13% of regional exports in 1988 to 21% in 1993. Moreover, Latin American nations are entering an ever-expanding web of bilateral and regional trade agreements. Brazil, Latin America's largest economy, is at the heart of the most ambitious one, Mercosur. The European Union is already pursuing a free trade agreement with Mercosur. If the United States is not actively involved as a leader in regional economic efforts, we risk being left out. Moreover, regional trade and investment agreements reached without our participation will not necessarily be up to U.S. standards for liberalization, and may actually be detrimental to U.S. interests.

Building Upon NAFTA

As it negotiates trade and investment liberalization with Chile, the U.S. Government must ensure that NAFTA (and, where it is better than NAFTA, the Uruguay Round) serves as the floor in all areas, and that any agreement with Chile improves upon that floor. The U.S. Government has consistently pursued ever-improving standards in its international economic agreements. For example, in many respects, the Uruguay Round is a significant improvement on previous GATT rules; in most areas, NAFTA is a major step beyond the U.S.-Canada Free Trade Agreement and the U.S.-Israel Free Trade Agreement. This trend of ratcheting up must continue unabated, and the goal of the United States must be to achieve NAFTA-plus levels of liberalization and protection in all future trade and investment negotiations.

While NAFTA is a strong agreement in many respects, in others it is lacking. Thus, NAFTA must be viewed as a floor upon which to build improvements. However, at the same time that it is building upon that floor, the United States should recognize that some provisions of NAFTA, such as its handling of customs procedures, technical standards, trade and investment in the automotive sector, agriculture, and sanitary and phytosanitary measures, are very good and should not be changed.

While sector-specific business groups, as well as individual companies, can provide more detailed proposals in their areas of expertise, the following list (which is not intended to be exhaustive) indicates some of the areas in which a NAFTA-plus agreement should improve on the original NAFTA:

Trade in Goods

- NAFTA-plus should phase out tariffs and non-tariff barriers faster than NAFTA did. The Roundtable continues to support phase-out, rather than immediate elimination, of appropriate tariffs and non-tariff barriers. However, NAFTA-plus should have a faster phase-out schedule than NAFTA, under which some tariffs will not be eliminated for 15 years.

Investment

- NAFTA achieved major investment liberalization. However, reservations were taken by NAFTA countries in some significant areas, most notably Mexico's reservations for the energy sector. NAFTA-plus should ensure that no important sectors are excepted from liberalization commitments.

- NAFTA did not eliminate all types of performance requirements. NAFTA-plus should conclusively prohibit all such measures.

- NAFTA did not sufficiently prohibit investment screening. NAFTA-plus should prohibit all forms of investment screening, except for narrowly-defined national security screening.

Services

- The substantive rules of NAFTA accomplished significant liberalization. However, reservations were taken in some sectors of great importance to U.S. companies, most notably telecommunications and financial services. Thus, some aspects of trade in these sectors were not sufficiently liberalized, or liberalization was delayed. NAFTA-plus should liberalize services markets beyond NAFTA's accomplishments. In particular, any four-party talks should include negotiation of basic telecommunications services, which were excluded from NAFTA. Such negotiations would be consistent with the ongoing WTO telecommunications negotiations.

Intellectual Property

- NAFTA is, in many respects, the best intellectual property agreement reached yet by the United States. However, it has several weaknesses, all of which should be cured by NAFTA-plus. The Administration should fully consider the comprehensive recommendations of the IFAC-3 regarding improvements to NAFTA.

Government Procurement

- Under NAFTA, Mexico will not be required to fully open procurement by PEMEX and CFE for ten years. NAFTA-plus must not permit such derogations, and should ensure full access by U.S. suppliers to all significant Chilean government entities.

Energy

- NAFTA did not go far enough to liberalizing energy trade, especially since Mexico took reservations to some of the energy provisions. NAFTA-plus should prohibit import/export measures on energy goods, except to the extent necessary to respond to defense-related needs. Moreover, where short supply export restrictions are imposed, NAFTA-plus should require national treatment.

- NAFTA-plus should ensure full freedom for foreign companies to invest in the energy sector.

Other Issues

- NAFTA does not address a continuing problem in developing countries -- corruption. NAFTA-plus should include provisions for intergovernmental cooperation to enforce laws against corrupt practices.

- NAFTA permits Canada to take "cultural exemptions" from certain provisions. This cultural exemption is specific and peculiar to the U.S.-Canada relationship, and is entirely inappropriate for any other country. NAFTA-plus should not include any such exemption for Chile; moreover, U.S. negotiators should seek to eliminate or at least substantially narrow the exemption for Canada.

The United States Should Consider All Options for Achieving NAFTA-Plus Liberalization

The United States can achieve NAFTA-plus levels of trade and investment liberalization measures during the negotiations with Chile through three approaches.

- NAFTA-plus four-party agreement -- During the accession negotiations with Chile, improvements can be made to NAFTA's substantive provisions.

- NAFTA-plus through a supplementary agreement -- Chile could negotiate a supplemental agreement with the United States (or all the NAFTA parties) that goes beyond the substantive elements of NAFTA.

- NAFTA-plus through self-initiated reforms -- Chile can continue its own liberalization initiatives. This was the approach taken by Mexico in the run-up to the NAFTA negotiations.

Each of these approaches has its merits. All else being equal, The Business Roundtable believes that the most beneficial would be to pursue NAFTA-plus negotiations with Canada, Mexico, and Chile. This would help cement NAFTA, create an opportunity to improve it, and confirm its utility as a building block to future trade and investment liberalization in Latin America. This last point is particularly important. As overlapping trade agreements, free trade areas, and customs unions proliferate in Latin America, it is important that the United States be able to hold out hold out a NAFTA-plus as the best trade agreement in the region and most available instrument for regional liberalization. However, if the dynamics and conflicting interests of a four-party negotiation prove too high a barrier to negotiation of a NAFTA-plus agreement, supplemental negotiations with Chile should be pursued as an alternative.

The above approaches are not mutually exclusive. In particular, regardless of the general approach to negotiations, the U.S. Government should encourage the Chilean Government to continue to build on its own initiatives to liberalize and reform its economy. For example, Chile could accelerate implementation of its Uruguay Round commitments, especially regarding the TRIPs, TRIMs, and Subsidies Agreements.

Labor and Environment Issues

The principal objectives of trade agreements have been and should remain the liberalization of trade and investment and the promotion of economic growth. Trade expansion and economic growth create social and financial conditions conducive to achieving improved working conditions. The successful conclusion of a trade and investment negotiation should not be compromised or delayed by ancillary efforts to address labor issues by means of an agreement whose fundamental objective is to liberalize trade and investment. The inconsistency of linking trade and labor policies is particularly troublesome because such conditionality would impede the achievement of both objectives.

In this light, a NAFTA-plus agreement with Chile should not include the environmental and labor agreements reached with Mexico and Canada in 1993. These side agreements were *sui generis* -- they are peculiar to the relationship between the United States and neighbors with which it shares a border. Because of the common border, pollution from Mexico or Canada often has, and has had, a direct impact on the United States. Similarly, the common border with Mexico and the resultant ease of immigration have direct effects on the U.S. labor market. These factors do not apply to the U.S. - Chilean relationship. At its closest point, Chile is nearly 3,000 miles from the U.S.

mainland. Environmental and labor conditions in Chile have no direct effect on the United States. Thus, while the NAFTA supplemental agreements may have been appropriate in light of direct impacts on the United States, it would be inappropriate to extend them, especially the provisions regarding monetary enforcement assessments and suspension of benefits, to Chile.

However, cooperative labor and environmental efforts between the United States and Chile are entirely appropriate. The Chilean government has apparently expressed interest in such efforts, and the U.S. Government, private sector, and NGOs should pursue them. The Roundtable strongly supports the cooperative elements of the side agreements and believes they provide an excellent basis for negotiating new labor and environmental agreements with Chile.

In general, labor and environment objectives are important and should be pursued vigorously through initiatives that are separate or parallel to those on trade and investment. Progress on one of these fronts should not be held hostage to progress on the other. Making the achievement of an environmental or labor objective conditional upon achieving a separate trade and investment objective, or vice versa, will impede the achievement of both objectives. Such strict "conditionality" should be avoided.

Conclusion

The Business Roundtable believes that if these guidelines are followed, negotiation of Chile's accession to NAFTA will be successful. We look forward to close cooperation and additional consultation with the Administration as negotiations proceed.

COMMITTEE ON AGRICULTURE
SUBCOMMITTEE ON DEPARTMENT OPERATIONS, NUTRITION, AND FOREIGN AGRICULTURE
RANKING MINORITY MEMBER
SUBCOMMITTEE ON RESOURCE CONSERVATION, RESEARCH, AND FORESTRY

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON ECONOMIC GROWTH, NATURAL RESOURCES, AND REGULATORY AFFAIRS
SUBCOMMITTEE ON NATIONAL SECURITY, INTERNATIONAL AFFAIRS, AND CRIMINAL JUSTICE

GARY A. CONDIT
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July 7, 1995

The Honorable Phil Crane
Chairman
House Subcommittee On Trade
1104 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Crane:

In light of your June 21, 1995 subcommittee hearing on accession of Chile into the North American Free Trade Agreement, I would like to submit for the record a letter from 42 members of the California delegation regarding this issue. I would appreciate you including this in the committee record if possible.

Thank you for taking this matter into consideration. I look forward to working with you on this issue as it moves through Congress.

Sincerely,

GARY A. CONDIT
Member of Congress

GAC/rg

THIS STATIONERY PRINTED ON PAPER MADE OF RECYCLED FIBERS

Congress of the United States
House of Representatives
Washington, DC 20515

June 22, 1995

The Honorable Mickey Kantor
United States Trade Representative
600 17th Street, N.W.
Room 209
Washington, DC 20506

Dear Ambassador Kantor:

It is likely that the United States and Chile will enter into formal accession negotiations very soon. While we believe this possible agreement is another positive step towards promoting the larger goal of trade liberalization throughout the world, we also believe that the U.S. wine tariffs should not be lowered in any agreement with Chile.

Currently, the United States already has the lowest wine tariffs of any major wine producing country. Also, the domestic wine industry has suffered greatly as a result of recent trade agreements adopted by the United States. Given these dynamics, the United States wine industry would bear extreme adverse consequences, while Chilean wine producers would enjoy tremendous benefits from an accord that would further erode the U.S. wine industry's competitiveness in a world market. There are several reasons we have come to this conclusion:

- **The Uruguay Round agreement lowered the U.S. tariff on wines, which are already the lowest of any major wine producing country, by 36%, when other countries, including members of the European Union, are lowering their higher tariffs by only 10% - 20%;**

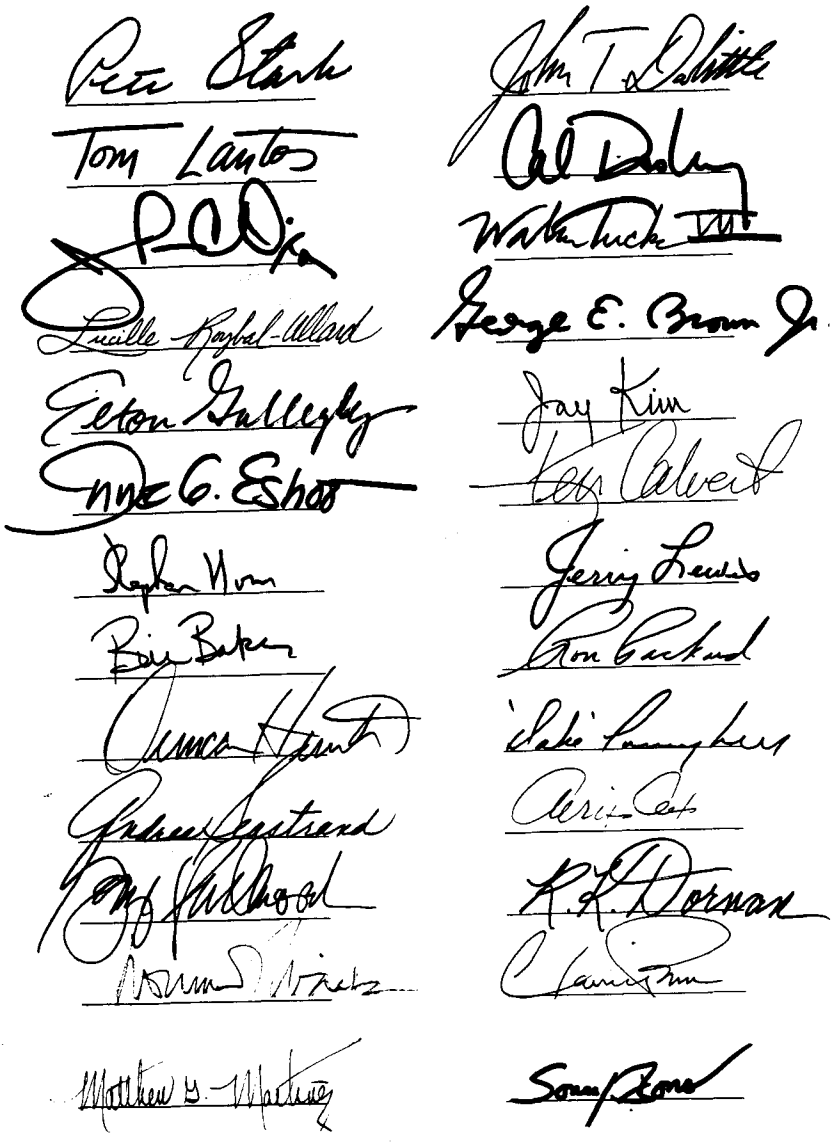
- **NAFTA's immediate opening of the U.S. brandy market to duty-free competition from the much larger Mexican brandy industry on an unreciprocated basis; and**

- **The wine provisions in the NAFTA and the Canada/US Free Trade Agreement have enable Chile to benefit from discrimination against the U.S. wines by Mexico and two key Canadian provinces.**

The industry's estimate shows that over 600,000 jobs depend upon the U.S. wine industry. The facts bear out that both the U.S. wine industry and the domestic wine grape growers have not been accorded a "level playing field" on which to compete. The time has come for this important domestic industry to stop being a "negotiation tool" for international trade agreements.

Thank you for looking into this matter. We look forward to your reply.

Sincerely,



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July 13, 1995

The Honorable Philip M. Crane
Chairman, Subcommittee on Trade
Committee on Ways & Means
U.S. House of Representatives
Washington, D.C. 20515

Re: Hearing on Accession of Chile to the North American Free Trade Agreement (6/21/95)

Dear Mr. Chairman:

This firm represents Cooper Tire & Rubber Company ("Cooper"), one of two remaining U.S.-owned full-line tire manufacturers. Although Cooper sells tires in some 80 countries and sold tires in Mexico before implementation of the NAFTA, Cooper is currently precluded from selling tires into Mexico because of unfair Mexican trade barriers. These Mexican trade restrictions -- and their future implications for an expanded NAFTA -- are also of concern to other U.S. tire producers, including Goodyear and Dunlop.

At the Trade Subcommittee's June 21 hearing on Chile's accession to the NAFTA, Congressman Payne questioned Ambassador Charlene Barshefsky about Mexican trade barriers against imports of U.S.-made tires and the implications of these trade barriers for the future expansion of the NAFTA. Ambassador Barshefsky testified that the continuation of Mexico's trade barriers against U.S. tires was unacceptable to the United States.

Cooper has prepared the enclosed chronology of its frustrating two-year effort to resolve this issue with the Mexican government. This detailed chronology shows how Mexico imposed new trade restrictions on imported tires after the implementation of the NAFTA and details Mexico's continued unwillingness to resolve this important dispute. Because this chronology is instructive on the important issue raised by Congressman Payne's question of Ambassador Barshefsky, Cooper requests that it be included in the record of the hearing.

Thank you for your attention to this important matter.

Sincerely,

Beryl F. Anthony, Jr.

cc: Richard Teeple, Esq. (Cooper Tire & Rubber Co.)
Frederick Ikenson, Esq.

MEXICO REFUSES TO ELIMINATE UNFAIR TRADE BARRIERS AGAINST U.S.-MADE TIRES

Cooper Tire & Rubber Company ("Cooper") is one of two remaining U.S.-owned full line tire producers. Its manufacturing plants in Ohio, Arkansas, Georgia and Mississippi produce tires which Cooper sells to some 80 countries worldwide.

Cooper exported U.S.-made tires to Mexico before the implementation of the NAFTA and expected that the NAFTA would expand the Mexican market for U.S. tires. Since the implementation of the NAFTA, however, Cooper and other U.S. tire producers and marketers have effectively been shut out of the Mexican tire market by a series of shifting non-tariff trade barriers erected by Mexico with the strong support of Mexican industrial interests, even while Mexican companies have been able to market their tires in the U.S. duty-free. These unfair trade barriers include:

- **certification requirements** that effectively require that Cooper have its tires tested and certified -- at considerable expense -- by its Mexican competitors, requirements contrary to accepted international standards, present U.S. and Canadian practices and past Mexican practices; and

- **labelling requirements** that require that certain information be molded into the sidewall of the tire, requirements that depart from international standards and practice, which employ English language molded sidewall information.

Cooper has been seeking the elimination of Mexico's unfair trade barriers on U.S.-made tires for more than two years. Cooper officials and representatives have met and corresponded repeatedly with U.S. and Mexican officials, including Ambassadors Kantor and Jones and President Zedillo. Cooper's efforts are summarized in the following chronology. As noted below, Mexico continues to impose its unfair trade barriers on Cooper and other U.S. manufacturers and has failed to respond to U.S. Government proposals to resolve the dispute on tires.

* * *

Chronology

August 3, 1992	New Mexican Technical Regulations ("NOMs") for tires published in the Diario Oficial with an effective date of September 24, 1992.
September 18, 1992	Letter from Peter J. Pantuso, Vice President Government Affairs, Rubber Manufacturers Association ("RMA"), to Don Phillips, Assistant U.S. Trade Representative for Industry, Office of the United States Trade Representative ("USTR"), expressing concern over the new Mexican NOMs for tires, and raising the possibility there might be technical barriers to trade which would impact the flow and the cost of U.S.-made tires shipped from the U.S. to Mexico.

September 24, 1992	Mexico commences rigid enforcement of Mexican NOM standards for tires which has effectively barred Cooper Tire & Rubber Company ("Cooper") from the Mexican tire market. The Mexican NOM standard for tires require conformity assessment by a certified Mexican testing laboratory in order to obtain a NOM number. The only available certified testing laboratories in Mexico for tires are the laboratories of Mexican tire companies. Therefore, in order for Cooper to obtain a NOM number under the new NOM standard, Cooper would have to send its tires to its competitors for testing. Mexican NOM standards and the U.S. Federal Motor Vehicle Safety Standards for tires ("FMVSS") are essentially identical. Cooper, in its own U.S. laboratories, already does the testing required by the Mexican NOMs for tires in order to self certify that tires meet the applicable FMVSS.
December 23, 1992	Letter from William J. Hession, Director Product Assurance, Cooper to Suzanne Troje, Director Technical Barriers to Trade, USTR, outlining the process for certifying compliance to Mexican NOM tire standards.
January 14, 1993	"U.S. Tire Manufacturers Protest Mexican Tire Testing and Certification Requirements" Source: RMA Press Release
February 9, 1993	Discussions in Mexico City between Ambassador John D. Negraponte and Ivan W. Gorr, Chairman of the Board, Cooper, regarding Mexico's non-tariff technical trade barriers for tires. Follow-up letter sent by Richard D. Teeple, General Counsel, Cooper, to Ambassador Negraponte providing background information regarding Mexico's non-tariff technical trade barriers for tires.
February 15, 1993	Letter sent to Dr. Jaime Serra Puche, Secretary of Commerce and Industrial Development ("SECOFI") by Richard D. Teeple, General Counsel, Cooper, providing background information regarding Cooper's inability to import tires into Mexico and Mexico's non-tariff technical trade barriers for tires.
February 26, 1993	Letter sent to Dr. Fernando Sanchez Ugarte, Undersecretary for Industry and Foreign Investment, by W. J. Hession, Director Product Assurance, Cooper, explaining the difficulties Cooper was facing in exporting tires to Mexico.
March 24, 1993	Meeting in Mexico City between USTR and Mexico Bureau of Normas, at which meeting the problem certain U.S. tire manufacturers were having in exporting tires to Mexico was analyzed and possible alternative solutions were discussed.
April 6, 1993	Letter sent to Luis Guillermo Iberra, Directora General de Normas, by Suzanne Troje, Director Technical Barriers to Trade, USTR, with letter from Robert F. Hellmuth, Director, Office of Vehicle Safety Compliance, National Highway Traffic Safety Administrator ("NHTSA") attached which

advised, in the opinion of NHTSA, that the Mexican NOMs for tires and the U.S. FMVSS for tires are for all practical purposes equivalent.

- April 13, 1993 — USTR published the 1993 National Trade Estimate Report on Foreign Trade Barriers. The report stated that implementation of Mexican labelling and certification requirements for U.S. exports of tires and the lack of transparency for U.S. businesses had resulted in export bottlenecks and lost U.S. sales.

- May 3, 1993 — Letter sent to Dr. Fernando Sanchez Ugarte, Undersecretary for Industry and Foreign Investment, by Richard Meier, Deputy Assistant U.S. Trade Representative for GATT Affairs advising the U.S. is awaiting a response to the U.S. proposal that the Government of Mexico recognize certification to U.S. FMVSS as demonstrating conformity to the relevant NOMs.

- May 13, 1993 — Meetings in Washington May 13, 14 and 17 between Luis Guillermo Ibarra, Directora General de Normas, and representatives of USTR, NHTSA and RMA, during which Mexican Government officials agreed Mexico's safety standards were virtually identical to U.S. FMVSS and testing in Mexico was not essential.

- June 13, 1993 — Letter sent to Suzanne Troje, Director Technical Barriers to Trade, USTR, by Peter J. Pantuso, Vice President Government Affairs, RMA, as a follow-up to the meeting with Louis Guillermo Ibarra, Directora General de Normas, on May 13, 1993.

  Issues discussed during the May 13th meeting were:
  1. Tire testing;
  2. Tire quality grading; and
  3. Labelling.

  Mr. Pantuso advised that any form of permanent labelling is unacceptable to U.S. tire manufacturers and should be unacceptable to any tire manufacturers operating in a world marketplace.

- January 1, 1994 — Under NAFTA, tires manufactured in Mexico are now entered into the U.S. duty-free in direct competition with Cooper in the U.S. replacement tire market. Mexico's 20 percent tariff on U.S. tires, on the other hand, is not to be phased out until 1998.

- January 4, 1994 — Letter from USTR to William J. Hession, Director Product Assurance, Cooper, advising that USTR had secured a commitment from the Government of Mexico to recognize tire testing performed in the United States by U.S. tire manufacturers for purposes of obtaining NOM certification for tires.

- February 16, 1994 — Coopermex, a wholly-owned Cooper subsidiary, was granted NOM Certification for certain tires by the Ministry of Communications and Transportation ("SCT") based upon Cooper's test data.

	On May 26, 1994 Cooper's Mexican counsel advised that additional Mexican NOM Certifications were granted to Coopermex for certain additional automobile and truck tires by SCT based upon Cooper's U.S. test data.
March 7, 1994	New Mexican labelling regulations issued.
April 4, 1994	"Some RMA members have experienced delays at the Mexican border due to new labelling requirements in Mexico." "Department of Commerce has stated the regulations are a barrier to trade and will be in Mexico the week of April 11 for negotiations." Source: RMA Public Affairs Bulletin Board, Monday, April 11, 1994
May 26, 1994	Cooper advised by Mexican Counsel that Cooper had received additional NOM numbers for Cooper tires.
June 20, 1994	The Government of Mexico published an additional proposed Spanish-language factory labelling and product information regulation.
September 2, 1994	U.S. government alerted the Automotive Parts & Accessories Association ("APAA") of Mexico's unpublished decision to require factory original Spanish language (or bilingual) labelling on aftermarket and all other products imported for direct sale to consumers. Source: Automotive Parts & Accessories Association "The last word", Volume III, Number 31.
September 26, 1994	RMA files comments with the Mexican government regarding the June 20, 1994, proposed labelling rule.
September 27, 1994	Cooper was advised by Cooper's Mexican counsel that Cooper's test data would no longer be accepted by the Government of Mexico for purposes of obtaining NOM certification for tires. Cooper would have to prove Cooper's laboratories are registered before the Mexican National System of Certification of Test Laboratories ("SINALP"). [SINALP will only certify Mexican laboratories so it was impossible for Cooper to comply.] Almost simultaneously with the foregoing, Cooper had a shipment of tires at the Mexican border which were denied entry into Mexico because Cooper's test data for Mexican NOM Certification was not from a certified Mexican testing laboratory.
September 30, 1994	New NOM standards are published for automobile tires in the Diario Oficial.
October 18, 1994	Cooper is further advised by Cooper's Mexican counsel that Cooper's NOM numbers may be revoked because its laboratories were not registered with SINALP.

November 3, 1994

Meetings in Mexico City between Mrs. Vilafana, SECOFI Director of Quality Certifications (NOM), Mr. Gonzales, who was in charge of promulgating Mexican NOMs for SECOFI, Mexican tire manufacturers, Mexican tire importers and representatives of Cooper. The position taken by the SECOFI representatives was:

a) "Tube-type" and "Tubeless" must be molded on the tire's sidewall in Spanish.
b) NOM certifications must be renewed annually.
c) NOM standards for tires do not apply to tires on imported vehicles.
d) Testing not required if the manufacturing facility is an ISO 9001 certified facility certified by a Mexican Authority.
e) For a foreign laboratory to be certified, there must be an agreement between Mexico and the foreign government and the foreign laboratory must be recognized by the foreign government.

November 11, 1994

A NOM standard was published describing the requirements for marking products with the applicable NOM number.

November 17, 1994

An unpublished agreement was entered by and among Mexican tire manufacturers and the Bureau of NOMs, whereby SECOFI permitted Mexican tire manufacturers to use a rubber patch to meet the molded Spanish labelling requirement of the NOMs. [Mexican manufacturers have continued to use rubber patches to comply with the NOM labelling requirements.]

December 19, 1994

Meeting in Mexico City between Raul Ramos Tercero, Sub Secretario de Industrial SECOFI; Patrick W. Rooney, Chairman of the Board, Cooper; Richard D. Teeple, General Counsel, Cooper; and Edward H. Reading, Director International Sales, Cooper; during which the Cooper representatives requested the Government of Mexico to eliminate Mexico's non-tariff technical trade barriers for tires and to adopt the international standards for tires.

January 23, 1995

Cooper and other tire manufacturers and distributors identified the same Mexican non-tariff technical trade barriers for tires in their responses to NHTSA's "Request for Comments on Incompatibilities in Automotive Standards That Apply in Canada, Mexico and the United States", published in Federal Register/Vol. 59, No. 246/Friday, December 23, 1994/Notices.

January 30, 1995

Meeting in Mexico City between Richard D. Teeple and Edward H. Reading of Cooper and C. Lic. Maria Eugenia Bracho, Directora General de Normas, regarding Mexico's tire NOMs and the barriers they present against importation of tires into Mexico.

A second meeting, chaired by C. Lic. Maria Eugenia Bracho, Directora General de Normas, was attended by Cooper representatives, and also in attendance were representatives from Mexican tire manufacturers and Mexican tire importers.

January 31, 1995	Meeting between Suzanne Troje, Director Technical Barriers to Trade, USTR and U.S. tire industry representatives, to discuss Mexico's non-tariff technical barriers for tires.
February 10, 1995	Meeting in Mexico City between Ivan Gorr, Director, Cooper, Dr. Herminio Blanco Mendoza, Secretario de. Comercio y Formento Industrial and Raul Ramos Tercero, Sub Secretario de Industrial SECOFI during which Mr. Gorr pressed the Government of Mexico to eliminate Mexico's non-tariff technical barriers for tires.
February 10, 1995	Letter presented to President Zedillo in Mexico City by Ivan Gorr, Director of Cooper, urging the President's support in conforming Mexico's NOM standards for tires to international standards including those of the U.S. and Canada. Mr. Gorr was among a group of U.S. executives honored by President Zedillo for their work in support of NAFTA.
February 13, 1995	Letter from Richard D. Teeple, General Counsel, Cooper to C. Lic. Maria Eugenia Bracho, Directora General de Normas, summarizing Cooper's position regarding Mexico's tire NOMs.
March 1, 1995	Meeting in Mexico City between Ambassador Jones and Richard D. Teeple, General Counsel, Cooper to discuss Mexico's non-tariff technical barriers contained in Mexico's NOMs for tires.
March 3, 1995	C. Lic. Maria Eugenia Bracho, Directora General de Normas advises Cooper's Mexican counsel that Cooper is no longer invited to attend the meetings on Mexico's NOM standards for tires at SECOFI.
March 23, 1995	Meeting between Suzanne Troje, Director Technical Barriers to Trade, USTR and U.S. tire industry representatives, to discuss further Mexico's non-tariff technical barriers for tires and a U.S. proposal for the elimination of Mexico's non-tariff technical trade barriers for tires.
April 19, 1995	Cooper filed a writ, at the request of C. Lic. Maria Eugenia Bracho, Directora General de Normas, with the General Direction of Norms, General Adjoint Direction of Operations, Direction of Official Certification, SECOFI, setting forth Cooper's proposal for revising Mexico's NOM standards for tires. Such proposal would have eliminated Mexico's non-tariff barriers for tires. Cooper received a letter dated April 26, 1995 from Ing. Carlos Martinez Nava, Director of Official Certification, Official Certification Division, General Division of Norms which appears to be a denial of Cooper's writ.
April 20, 1995	The USTR submits to the Government of Mexico a proposal for revising Mexico's NOM standards for tires. Such proposal would eliminate Mexico's non-tariff barriers for tires. To date, no response has been given to USTR by the Government of Mexico.
May 3, 1995	Meeting in Mexico City between C. Lic. Maria Eugenia Bracho, Directora General de Normas and Richard D. Teeple, General Counsel, Cooper, to

	discuss the proposed new Mexican NOMs for tires which were supposed to have been issued in a few weeks but, to date, have never been issued.
May 11, 1995	Update meeting with Suzanne Troje, USTR, and discussion of the U.S. proposal to Mexico for the elimination of Mexico's non-tariff technical trade barriers for tires.
May 15, 1995	Meeting at the Mexican Embassy in Washington between Luis de la Calle and Richard D. Teeple, General Counsel of Cooper, at which the Government of Mexico was urged to eliminate Mexico's non-tariff technical trade barriers for tires and to adopt the international standards for tires.
May 16, 1995	U.S. Trade Representative Mickey Kantor advises SECOFI Secretary Bianco at meeting of the U.S.-Mexico Binational Commission that the United States will invoke NAFTA dispute settlement procedures if the dispute on tires is not resolved promptly.
May 17, 1995	Ambassador Kantor testifies before a joint hearing of the House Ways & Means Trade Subcommittee and the House Rules Subcommittee on Rules and Organization that a response from Mexico on the tire dispute was expected on May 20 and that the United States "will not wait forever."
June 13, 1995	Cooper officials meet with Ambassador Kantor and Deputy USTR Charlene Barshefsky, and are told that the USTR is continuing to seek a response from Mexico.

Emergency Committee for American Trade 1211 Connecticut Ave. N.W. Washington, D.C. 20036 (202) 659-5147

STATEMENT OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE
ON THE ACCESSION OF CHILE
TO THE NORTH AMERICAN FREE TRADE AGREEMENT

The Emergency Committee for American Trade (ECAT) strongly supports the accession of Chile to the North American Free Trade Agreement (NAFTA). In many admirable ways, Chile offers a model of modern economic development. It would be good to forge a close economic relationship with this important country.

The approximately 60 members of ECAT are all U.S.-headquartered companies with extensive overseas business interests. Their annual worldwide sales are over $1 trillion. They employ about five million workers, and they account for a substantial portion of U.S. exports. ECAT member firms operate facilities in every state and in nearly all 435 congressional districts. They purchase tens of billions of dollars of materials and supplies for their manufacturing and other activities in the United States from tens of thousands of firms of all sizes throughout the United States.

While we do not know precisely how many ECAT firms conduct business with Chile, we would venture that most do. Chile has a growing and stable market that offers good business prospects for U.S. business. These prospects would be considerably enhanced by Chile's becoming a members of the NAFTA, thereby accepting its obligations and rules. Chile's accession would signal other Latin American nations of the U.S. resolve to achieve the hemispheric free trade goals of last year's Summit of the Americas.

Indeed, the recent start of discussions for Chile's NAFTA accession among what Canadian Prime Minister Jean Chretien referred to as the "four amigos" appear to have gone well. The speed of the accession negotiations will depend heavily on the timing of another grant of fast track trade negotiating authority for the President. As our ECAT Chairman, Duane Burnham, testified at a May 11, 1995, joint hearing of the Ways and Means Subcommittee on Trade and the Rules and Organization Subcommittee of the House Committee on Rules, ECAT is strongly supportive of such a grant of authority so that the President can negotiate trade agreements with Chile or with any other country or groups of countries.

Perhaps the most controversial aspect of a new grant of fast track authority is whether it should include labor and environmental considerations. As Mr. Burnham stated on behalf of ECAT during his May 11 testimony, ECAT is opposed to the inclusion of labor and environmental issues as objectives of trade negotiations. As he also stated, ECAT is in no way opposed to international negotiations on these issues in non-trade forums such as the International Labor Organization (ILO) or other appropriate international bodies. In fact, we believe it appropriate and desirable that the United States negotiate such agreements to improve labor standards and to safeguard the environment. We simply do not believe that trade negotiations are an appropriate forum.

Among other comments that we would offer on this issue is that since there is little domestic or international consensus on labor and environmental issues, we do not believe that international agreements on these issues should be considered by the Congress outside the normal legislative process. We in ECAT and the business community generally are also adamantly opposed to the use of trade sanctions as a means of seeking or attaining labor or environmental objectives or of expressing U.S. displeasure with foreign labor or environmental measures.

We are opposed to the NAFTA labor and environmental side agreements being part of any prospective NAFTA accession agreement with Chile. Those side agreements are peculiar to the original three members of the NAFTA who share a common geography and borders. That uniqueness does not apply to Chile or to any other prospective members of NAFTA.

We understand that Chile is willing to become a signatory to these side agreements. In light of this, we think it entirely appropriate that the United States consider such separate agreements on labor and environmental matters as may mutually be agreeable. Such agreements could advance U.S. labor and environmental objectives, and it could very well be in the best interests of the United States that we pursue them, but not in the context of a trade negotiation.

In its willingness to enter into the NAFTA side agreements on labor and the environment, Chile could well be unique among Latin American nations. From what we hear and read, other Latin American and other developing countries of the world are very much opposed to labor and environmental issues being made part of trade negotiations. Whether their concerns are valid or not, many of these countries are concerned that such non-trade issues could be used by the industrial countries as "protectionist" devices to restrict imports.

Although the NAFTA is perhaps too new to be amended, the accession negotiations with Chile do provide the opportunity to seek desired changes in its provisions. Additions to the NAFTA in such important areas as basic telecommunications services, which were excluded from the NAFTA, would be most desirable.

Let us conclude by again stating ECAT's strong support for Chile's accession to the NAFTA. It would initiate a new era in U.S. relations with its Latin American allies.

STATEMENT OF THE INTELLECTUAL PROPERTY COMMITTEE REGARDING ACCESSION OF CHILE TO THE NORTH AMERICAN FREE TRADE AGREEMENT

SUBMITTED TO THE HOUSE COMMITTEE ON WAYS AND MEANS SUBCOMMITTEE ON TRADE

The Intellectual Property Committee (IPC) is pleased to offer these comments on U.S. negotiations with Chile towards its accession to the North American Free Trade Agreement (NAFTA). The IPC, whose membership represents the broad spectrum of private sector U.S. intellectual property interests, closely monitors developments in key U.S. trading partners as they relate to the level of intellectual property protection and the closely related issue of market access for intellectual property-intensive industries. To this end, the IPC has worked closely with U.S. negotiators and Members of Congress, especially members of this subcommittee, during the Uruguay Round and NAFTA negotiations, as well as in the development of U.S. policies to accelerate implementation of the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement) and to further improve intellectual property protection worldwide.

The IPC believes that the negotiation of a free trade agreement with Chile presents important opportunities for the United States, and therefore supports U.S. efforts to liberalize trade and investment with Chile. However, while Chile has made progress towards offering adequate and effective protection of intellectual property, U.S. companies and other intellectual property rights holders continue to experience many problems with Chile's legal regime of intellectual property protection and its enforcement of that regime. Thus, in any negotiations with Chile, the U.S. Government must ensure that it achieves significant improvement in Chilean protection and enforcement of intellectual property rights.

Specific Intellectual Property Problems in Chile

The U.S. Government should insist on at least the following improvements in Chile's intellectual property regime, all of which would be achieved by full Chilean implementation of NAFTA and the TRIPs Agreement:

Patents

- Chile's patent term of 15 years from grant is too short and, in any event, is below the standards contained in the TRIPs and NAFTA Agreements. Chile should immediately bring its patent term up to the requirement of 20 years from date of filing contained in the TRIPs Agreement. This 20-year term must be applicable to all patents in force at the time the new term goes into effect, as required by TRIPs Article 70.2 and NAFTA Article 1720:2.

- Chile should implement pipeline protection for all pharmaceutical and agrichemical products for which patents were issued abroad before September 30, 1991. This pipeline protection should extend for the full life of the foreign patent term. Moreover, the U.S. Government should seek a standstill provision during free trade negotiations with Chile so that marketing of a product in Chile while negotiations are ongoing does not cause loss of pipeline protection rights.

- Chile should make patents available for software inventions.

Copyrights

- Software piracy is a major problem in Chile -- the Business Software Alliance estimates a piracy rate of over 70% for 1993, and possibly higher in 1994. This partly stems from gaps in Chile's copyright laws. Chile should define software as a literary work under the Berne convention, clearly provide rental rights for software, and implement adequate protection for databases and compilations.

- Chile should provide the right of importation for sound recordings and literary works.

- Chile should make it a criminal offense to manufacture, import, sell, lease, or otherwise make available equipment for decoding encrypted satellite signals without authorization. Civil penalties and injunctive relief should also be available for unauthorized distribution of programs and signals.

- Chile should delete overbroad exceptions in its law regarding the use of photographs; these exceptions are incompatible with the Berne Convention Article 9(2) provision regarding exceptions to protection for works. Moreover, Chile's general exception for private copying for personal use must be circumscribed to meet NAFTA and TRIPs requirements.

- Chile should add the definition of "public" contained in NAFTA Article 1721 to its copyright law.

- Chilean law should allow an author to waive moral rights; this is critical in order for the owner of the economic rights to be able to finance and market a work.

- Chile should amend Article 80b of its copyright law by deleting the reference to "gainful intent."

Trademarks

- Chile should permit the registration of shapes and colors of products and their packages.

- Chile should be more generous in allowing extension of time within which to oppose applications and to defend against oppositions.

Trade Secrets

- Chile should expand its law to provide comprehensive protection for trade secrets, as well as proprietary data required by governments for marketing approval of pharmaceutical and agrichemical products.

Enforcement

- Chilean law should be changed to include express provision for ex parte (unannounced) searches, which are key to effective enforcement of copyrights.

- Chilean law should expand the remedies available to authorities for curtailing copyright piracy. For example, authorities should explicitly be permitted to close commercial establishments that use illegal software and seize infringing goods.

- Chile provides inadequate penalties for copyright infringement -- the maximum criminal fine is less than $2,000, low enough to be factored in as a cost of doing

business by commercial pirate enterprises. Penalties should be increased to have a significant deterrent effect.

- Chile should meet all the enforcement provisions in NAFTA Articles 1714-1717, as well as border enforcement measures in Article 1718 (which are also found in TRIPs Part III).

Other Issues

- Chile should extend protection to semiconductor mask works.
- Chile should accede to the International Convention for the Protection of New Varieties of Plants (UPOV Convention).
- The U.S. Government should ensure that Chile does not implement any new laws that will reduce intellectual property protection. The IPC is particularly concerned about a law under consideration that would exempt imported goods from process patent protection.
- Chile should assure the United States that it will not utilize the TRIPs transition periods for developing countries.

General Views

The U.S. Government and Congress have a long history of international initiatives to improve foreign protection of intellectual property rights held by U.S. citizens and companies. Special 301 and preferential trade program conditionality contained in legislation passed by Congress have provided the U.S. Government with important tools to encourage adequate and effective intellectual property protection. The TRIPs Agreement, despite its flaws, provides a baseline of protection on a multilateral basis. The intellectual property chapter of the NAFTA is even better, providing a strong base upon which to build in the future.

It is vital that, in negotiating trade and investment issues with any country, the U.S. Government continues its strategy of aggressively seeking improved intellectual property protection. In all negotiations, including those with Chile, the U.S. Government should ensure that NAFTA, the best international intellectual property agreement negotiated to date by the United States, serves as the floor for agreement, and that all agreements improve significantly upon that floor. NAFTA-plus levels of intellectual property protection are needed for several reasons. First, the United States must continue to pursue fully adequate and effective intellectual property protection abroad; NAFTA does not yet provide that level of protection. Second, the NAFTA text is now several years old. Its provisions are not necessarily adequate nor appropriate at this point in time, given changes in technology and the dynamics of a new free trade negotiation. Finally, the TRIPs agreement, in some areas, improves upon NAFTA; any new agreement based on NAFTA must incorporate these improvements.

There are several approaches for achieving intellectual property protection at a NAFTA-plus level in Chile. First, the United States can use the occasion of negotiations with Chile to also negotiate with Canada and Mexico to improve NAFTA's intellectual property provisions. This approach would help solidify the NAFTA, provide an opportunity to improve it, and confirm its utility as a building block to future agreements in Latin America. This last point is particularly important. As trade agreements proliferate in Latin America, there is a risk that overlapping arrangements may result in conflicting intellectual property provisions, to the detriment of U.S. interests. It would be beneficial if the United States could hold out a NAFTA-plus agreement as the best in the region and the

most readily available instrument for regional liberalization. However, if the U.S. Government takes this approach, it is critical that the progress already made in the NAFTA towards adequate and effective intellectual property protection not be undermined.

If the dynamics and conflicting interests of a four-party negotiation prove too high a barrier to negotiation of a NAFTA-plus accord, Chile could instead negotiate a supplemental agreement with the United States (or with all the NAFTA parties) that includes NAFTA-plus levels of intellectual property protection. In addition, regardless of the shape of negotiations, the United States should also strongly encourage Chile to self-initiate improvements in its intellectual property protection as a down-payment to negotiations. This would parallel the approach taken by Mexico in the run-up to NAFTA, when it unilaterally undertook improvements to its intellectual property laws to facilitate negotiations.

Improvements Needed for NAFTA-Plus

As noted before, the negotiation of Chile's accession to NAFTA provides an opportunity to improve NAFTA's intellectual property provisions. Some of these improvements are needed to fill gaps that were identified by the private sector at the time NAFTA was concluded. Others are needed to bring intellectual property in line with constantly-changing technology. Among the most important areas for improvement are the following:

Patents

- Require patentability of plants and animals, and of diagnostic, therapeutic and surgical methods.
- Narrow the currently broad exceptions to patent rights in Article 1709:6.
- Tighten the compulsory patent licensing provision to ensure that importation meets any local working requirements.

Copyrights

- Require national treatment for a performer's right in secondary uses of sound recordings.
- Revise the language on rental, which currently limits the producer's right if a reservation to the author's right has been made.
- Require that performers be able to prohibit the unauthorized fixation, reproduction, or broadcast of their live performances.
- Set out full details for compliance with NAFTA and TRIPs obligations to provide full protection for preexisting works and sound recordings under the incorporated Article 18 of the Berne Convention.
- Require adoption of an audio levy system at least for digital media that incorporates Serial Copying Management System (SCMS) technology.
- Require adoption of a digital transmission right in a sound recording (if legislation to such effect is approved in the United States).

Trade Secrets

- Provide better protection of trade secrets by replacing the current gross negligence standard relating to third-party

acquisition with a negligence standard, expressly providing that protection is available against continued use and not merely acquisition by third parties, and removing the requirement that a trade secret be in tangible form to be protected.

- Extend protection of proprietary data provided to governments for marketing approval to data on old chemical entities that required considerable effort to originate.

- Explicitly extend ten years of protection for agrichemicals against "me too" registration.

Enforcement

- Improve obligations to provide minimum civil and criminal penalties and sanctions.

- Explicitly require that border controls against infringing imports be at the border and not, as currently required, "immediately after customs clearance . . ."

Other Issues

- Clarify language in Section 1720:4 on protection of existing subject matter.

- Clearly prohibit parallel imports.

- Expand Section 1707 (which covers encrypted program-carrying satellite signals) to cover encryption used in networks and on-line services, to extend criminal penalties to all violations of this section, and to make illegal tampering with measures employed as a part of copyright management information systems.

- Make passive noncommercial, unauthorized receipt of encrypted transmissions into a home or other premises a civil offense.

Moreover, the NAFTA permits Canada to take "cultural exemptions" from certain provisions. This cultural exemption is peculiar to the U.S.-Canada relationship, which is characterized by close geographical and linguistic proximity. It is entirely inappropriate for any other country, and any agreement with Chile must not include such an exemption. Moreover, in any quadrilateral NAFTA-plus negotiations, U.S. negotiators should seek to eliminate or at least substantially narrow the exemption for Canada.

Conclusion

The IPC believes that, if these guidelines are followed, Chilean trade and investment liberalization can be a great benefit to U.S. intellectual property interests. We look forward to further consultation and discussion with Congress, and in particular with members of this subcommittee, as negotiations progress.

International Intellectual Property Alliance

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aap
Association of American Publishers, Inc.

AFMA
American Film Marketing Association

BSA
Business Software Alliance

INFORMATION TECHNOLOGY INDUSTRY COUNCIL

ITAA
Information Technology Association of America

Motion Picture Association of America, Inc.

National Music Publishers' Association, Inc.

RIAA
Recording Industry Association of America, Inc.

July 13, 1995

Phillip D. Moseley
Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House
Office Building
Washington, DC 20515

Re: Chile NAFTA Accession

Dear Mr. Moseley:

The International Intellectual Property Alliance appreciates this opportunity to submit our comments regarding the proposed accession of Chile to NAFTA. The IIPA is a coalition of eight trade associations that represents the U.S. copyrighted-based industries -- computer software, films, videos, recordings, music and books.

IIPA and its members strongly supported NAFTA and strongly support the extension of a Free Trade Area to other countries in the region, starting with Chile. We do believe, however, that the NAFTA intellectual property chapter should be viewed as the beginning, rather than the end, of negotiations with Chile. Our detailed views on Chile's accession protocol are included in our May 5, 1995 letter to the Office of the U.S. Trade Representative regarding Chile's NAFTA Accession (attached). The key issues affecting IIPA members include: the current state of copyright protection and enforcement in Chile and its impact on the U.S. copyright industries, the appropriate scope of Chile's copyright protection and enforcement obligations under a NAFTA accession protocol, the timing of Chile's compliance with its international copyright protection and enforcement obligations, and selected market access issues.

Thank you for your consideration.

Sincerely,

Eric H. Smith
President

cc: Alliance Working Group

International Intellectual Property Alliance

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May 5, 1995

Ms. Carolyn Frank
Executive Secretary
Trade Policy Staff Committee
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20506

Re: Request for Public Comment on the Negotiation of Chilean Accession to the North American Free Trade Agreement, 60 Fed. Reg. 13746 (March 14, 1995)

Dear Ms. Frank:

This is in response to the request for comments from interested parties regarding the negotiation of Chile's possible accession to the North American Free Trade Agreement ("NAFTA") published in the Federal Register on March 14, 1995. The International Intellectual Property Alliance ("IIPA" or "Alliance") appreciates the opportunity to submit comments on this most important issue.

The IIPA is a coalition of eight trade associations (at left) that represent more than 1,500 companies that produce and distribute computers and computer software, motion pictures, television programs and home videocassettes; music and sound recordings; textbooks, tradebooks, reference and professional publications and journals. Together these industries rank among the largest and fastest growing sectors in the U.S. economy. In 1993, they accounted for 3.7% of U.S. GDP ($238.6 billion), grew more than twice as fast as the U.S. economy as a whole between 1991 and 1993 (5.6% vs. 2.7%), employed workers at nearly four times the rate of the economy as a whole between 1988 and 1993 (2.6% and 0.7%) and had foreign sales of $45.8 billion in 1993, a figure surpassed by only one other sector, that of automobiles and auto parts. While the U.S. economy increasingly depends on our citizens' creativity and technological prowess for maintaining our world economic leadership, that leadership is continually threatened by weak and ineffective intellectual property laws and enforcement regimes around the world and by other market access barriers adversely affecting these industries.

In these comments, IIPA will limit its discussion to the following:

1. The current state of copyright protection and enforcement in Chile and its adverse impact on the U.S. copyright industries;

2. The appropriate scope of Chile's copyright protection and enforcement obligations under a NAFTA accession protocol;

3. The timing of Chile's compliance with its international copyright protection and enforcement obligations and with the accession protocol;

4. Selected market access issues, including the "Cultural Exemption" for Canada.

A. Introduction: Support for Chile's Accession and the Accession Protocol

IIPA and its members strongly supported NAFTA and strongly support the extension of a Free Trade Area to other countries in the Hemisphere, starting with Chile. In particular for those industries and companies that critically rely on high levels of intellectual property protection as the sine qua non of doing business in a particular foreign market, free trade agreements, like NAFTA, which incorporate high levels of protection and enforcement, offer significant market opening advantages in terms of both exports and investment. IIPA believes that there are significant domestic advantages to be gained by a country, like Chile, from adopting high levels of protection and enforcement because of the demonstrable benefits to domestic intellectual property owners and consumers, regardless of whether other trade concessions are granted by its trading partners. IIPA recognizes, however, that is often politically easier for a country to sell a shift in status to higher protection if it is done in the context of an overall trade negotiation leading to major trade liberalization across the board. For this reason, the intellectual property community generally, including IIPA and its members, have continuously supported the NAFTA and its extension to the region as a whole. Latin America is an increasingly important market for U.S. copyright owners as copyright protection and enforcement improves and as other market access barriers affecting these industries begin to fall. It is of critical importance, therefore, that this momentum be sustained by early negotiation of a NAFTA-like FTA, initially with Chile and later with other countries in the region.

While IIPA strongly supports Chile's accession to an FTA with the United States, Canada, and Mexico as the current members of NAFTA, we would not support the simple adherence by Chile to the existing intellectual property chapter (Chapter 17) of the NAFTA. IIPA considers the NAFTA IP chapter as the beginning rather than the end of negotiations with Chile. It has been close to three years since the negotiations between the current NAFTA parties were completed and much has changed during this intervening period. Among the most important developments has been the completion and approval by GATT members of the TRIPS text which adds to the IP obligations that a country must meet in furtherance of its international obligations. At a very minimum these new obligations must be incorporated in an accession protocol for Chile. Furthermore, and as described in more detail under the discussion of the "scope" of obligations that Chile should meet, other world events, technological developments and changes in copyright developments in the United States warrant an opening of discussions on new issues that were not necessarily appropriate for discussion with other NAFTA parties in 1991 and 1992. The intervening of the GATT-TRIPS agreement completed in 1993, and formally approved in 1994, also affects the "timing" of Chile's obligations under a new NAFTA accession protocol for Chile. As noted in the "timing" discussion, Chile's TRIPS obligations commence on January 1, 1996. In most respects, therefore, Chile should have brought its domestic law -- and most importantly its enforcement system -- into compliance with its TRIPS obligations by then. Only a few, relatively minor, changes in law and practice will be necessary to meet the additional obligations that result from the current Chapter 17 of NAFTA and the further improvements recommended in these comments for adoption by Chile as part of its accession.

B. Discussion

1. The current state of copyright protection and enforcement in Chile and its adverse impact on the U.S. copyright industries.

Chile's copyright law and enforcement regime is deficient in a number of respects and must be updated to meet its obligations under GATT-TRIPS, and the standards in the NAFTA copyright and enforcement chapter.

Fortunately, however, most of the U.S. copyright-based industries find that the levels of piracy are low in Chile. For example, video and audio piracy levels in Chile are among the lowest in the entire region. The level of audiocassette piracy last year was about 14%, causing an estimated $3.5 million in trade losses. Reports also indicate that small numbers of imported pirate CDs have entered the Chilean market. Estimated losses due to book piracy, caused primarily by commercial photocopying, were $3 million in 1994. Losses due to video piracy are also low and figures are unavailable.

However, piracy does remain a significant problem for U.S. software publishers. BSA estimates that the level of software piracy is 84%, causing $46 million in losses to U.S. publishers due to piracy last year. Total losses due to piracy across all sectors were $52.5 million in 1994. This estimate places Chile as the sixth highest in the region in terms of copyright piracy trade losses.[1]

Chile has a number of deficiencies in its copyright law and enforcement regime which must be remedied as part of its accession to a protocol. The deficiencies in its statutory regime are summarized in Appendix A hereto. While IIPA has not yet had the opportunity to do a detailed article-by-article analysis of Chile's enforcement regime compared with the enforcement provisions of the TRIPS and NAFTA, we have highlighted a selection of deficiencies in this category also in Appendix A.

2. The appropriate scope of Chile's copyright protection and enforcement obligations under a NAFTA accession protocol.

As noted in the Introduction, IIPA believes that in the three years since the completion of the NAFTA and its IP chapter, a number of events have occurred that warrant negotiation of new obligations into a Chile accession protocol. These include the completion of the TRIPS agreement, the passage by Congress of the Uruguay Round Agreements Act (URAA) and the passage of other domestic copyright legislation that change the dynamics of any accession negotiation.

While it is true that the NAFTA IP chapter is generally stronger than the TRIPS text even though it was agreed to earlier, there are at least two areas where TRIPS may be superior to NAFTA in that it establishes higher obligations. Both of these changes impact the recording industry. First, Article 14.1 of the TRIPS agreement obligates all WTO member states to provide performers whose performances are embodied on sound recordings with the ability to prevent the unauthorized fixation, reproduction, or broadcast of their live performances. NAFTA does not contain any substantive obligations (though there are national treatment implications) to protect performers, as contrasted with the sound recordings on which such performances reside. The presence of such protection in TRIPS requires WTO members to protect U.S. performers from their performances being

[1] IIPA estimates that only Argentina, Brazil, Columbia, Mexico and Venezuela have higher dollar losses due to copyright piracy.

"bootlegged" and those "bootlegs" being traded internationally. The U.S. implemented this provision in the URAA by establishing a federal "antibootlegging" civil and criminal provision. While Chile protects performers generally and under its TRIPS obligations must now extend such protection to U.S. performers, such protection should be an explicit obligation under any Chilean NAFTA accession.

Second, Article 1706(d) of NAFTA establishes an exclusive right of commercial rental of a sound recording "except where expressly otherwise provided in a contract between the producer of the sound recording and the authors of the works fixed therein. If this proviso is interpreted so as to allow implementation in a manner that would limit the producer's intellectual property right to control rental, such interpretation and implementation would violate the TRIPS provision on rental (Article (4(4)) which contains no such limitation.

The URAA, which was signed by the President on December 8, 1994, also constitutes a major shift in U.S. law which affects how the obligation contained in NAFTA concerning retroactive protection should be worded. When NAFTA was negotiated in 1992, it remained unclear how the U.S. would implement Article 18 of the Berne Convention (which is incorporated into TRIPS by Article 9 and for sound recordings in Article 14.6) with respect to how certain foreign copyrights would be "restored" into copyright in the U.S. given possible constitutional issues that needed to be addressed. Under NAFTA, the U.S. agreed to restore into copyright in the U.S. only certain motion pictures. The U.S., however, demanded no specificity with respect to restoration of U.S. copyrights by other NAFTA parties except by merely citing to the Berne Convention. In a major development that IIPA hopes will set a worldwide pattern in this area, the U.S. Congress has created broad and sweeping restoration of protection for foreign copyrights, many as far back as 1919. This country took this action because it is required by GATT/TRIPS. It is essential that we secure similar broad and sweeping "restoration" of our valuable copyrights abroad. This issue of "restoration" has huge economic significance to the U.S. copyright industries in the worldwide marketplace, affecting works protected under the Berne Convention, and affecting sound recordings and performances. The opportunity to deal in detail with this issue in a NAFTA accession protocol with Chile must not be lost.

Again, since the completion of the NAFTA negotiation, the U.S. has adopted legislation obligating audio hardware and blank tape manufacturers and importers to pay a copyright levy to compensate copyright owners for unlicensed home copying of sound recordings and the music and performances embodied thereon. This legislation also mandates the incorporation of so-called "SCMS" ("Serial Copying Management System") technology into audio copying hardware to prevent the serial copying of digital audio media, like DAT ("Digital Audio Tape"). The levy proceeds are then distributed to all owners of copied works on the basis of national treatment without regard to nationality. The World Intellectual Property Organization (WIPO) has proposed that such a system be made mandatory at the international level. The opportunity should not be missed to set a pattern with Chile in this important area.

Finally, there is currently before the Congress a bill to create a digital transmission right in a sound recording and there will likely be another bill introduced this year to amend the U.S. Copyright Act to deal with electronic transmissions of all works over the Information Superhighways. Both bills could very well become law before the completion of a NAFTA accession protocol. The latter measure, expected to accompany the release by the Patent and Trademark Office of its "White Paper" on protection of content on the National Information Infrastructure, in addition to recommending some fine-tuning of substantive copyright law, is expected to propose critically important provisions that would

make illegal the tampering with hardware and software devices employed in the context of transmission on the NII that protect copyrighted works against unauthorized copying, transmission, viewing etc. In addition, it is expected that proposals will be made to deal with measures employed as part of copyright management information systems. These issues will be prominently discussed as part of the late June 1995 Summit of the Americas follow-on Ministerial and Trade and Commerce meetings to which Chile has been invited to participate. These are such critical issues for the future of U.S. trade in these new areas that the opportunity to open negotiations with our key Hemisphere trading partners should not be missed. We note that the NAFTA, in Article 1707, contains provisions making illegal the unauthorized interception of encrypted satellite signals and the sale of unauthorized devices that make such interception possible. This is but one aspect -- albeit that most immediately relevant to the neighboring countries of Mexico, U.S. and Canada -- of a broader "technical controls" provision that must be part of the U.S. negotiating strategy for the Hemisphere.

3. The timing of Chile's compliance with its international copyright and enforcement obligations and with the accession protocol.

The timing of when Chile's NAFTA protocol obligations become fully effective is critical for the U.S. and for IIPA and other sectors of the intellectual property community. Whether or not Chile must bring its laws and enforcement regimes into full compliance with the highest levels of protection noted here as a condition precedent to the U.S. signing a protocol or whether a transition period for certain issues will be permitted will be a major subject for negotiation. One conclusion, however, seems clear, namely that Chile must have brought its copyright and enforcement regime into compliance, at the very minimum, with its obligations under the TRIPS agreement which, in IIPA's view, enters fully into effect for Chile on January 1, 1996 as it does for the U.S. Chile may seek to argue that it qualifies for the "developing country" four year additional transition to bring its substantive copyright law and enforcement regime up to the standards mandated by TRIPS.[2] Under no circumstances should Chile be permitted to adopt this position. With one of the highest per capita incomes in Latin America, Chile should not be deemed eligible for such status and the U.S. position should be crystal clear that a NAFTA protocol for Chile is impossible without full compliance with its WTO obligations.

The question arises whether Chile should also meet the generally higher standards of protection afforded in Chapter 17 of the NAFTA before the U.S. signs an accession protocol with Chile. Since Chile must make a number of amendments to its copyright law and enforcement regime to the level of TRIPS (see Appendix A for an outline of the amendments needed), it would be very easy for Chile to meet the slightly different and usually higher standards in the NAFTA text. Most of these additional changes are not major and include, for example,

(a) greater clarity with respect to the protection of computer programs (Article 1705(1)),

(b) better and clearer elucidation of the exclusive rights that must be available for works and sound recordings such as a distribution right, including a rental right for computer programs and sound recordings (Articles 1705(2) and 1706(1)),

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[2] Even for countries that can take advantage of the four year transition period until January 1, 2000, the national treatment and MFN obligations of TRIPS nevertheless take effect on January 1, 1996.

(c) a slightly narrower exception from the exclusive rental right in computer programs than in the TRIPS text (Article 1705(2)(d)),

(d) limitations on the implementation of compulsory licensing (Chile has not implemented these licenses in any event and should not be permitted to do so since these privileges apply only to developing countries) (Article 1705(6)),

(e) provisions expressly allowing free contractual transfers of rights (Article 1705(3)),

(f) fewer permitted exceptions to national treatment (Article 1703(1)),

(g) limitations on exceptions to protection for sound recordings to those permitted for works in Berne Article 9(2) rather than the broader exceptions permitted under the TRIPS reference to the Rome Convention (Article 1706(3)),

(h) a definition of "public" in respect of the rights of communication and performance (Article 1721(2)), and

(i) the addition of a provision on protection of encrypted program-carrying satellite signals (Article 1707).

None of these changes should pose a major problem to Chile in respect of immediate amendments to implement them in domestic Chilean law.

The other amendments noted above not mandated in TRIPS or NAFTA (e.g. audio levies, public performance right in a sound recording at a minimum for digital media, technical controls and protection for copyright management information) could, if necessary, be mandated in a protocol after a short transition period, particularly if one of more of these provisions has not yet become effective in the U.S.

What is important is that a modern copyright regime should contain at a minimum the protections afforded in TRIPS and the current NAFTA and Chile should not be permitted to join the FTA until it has met these minimum criteria.

4. Selected market access issues, including the "Cultural Exemption" for Canada

a. General

In addition to the copyright protection and enforcement issues discussed above, there are a number of market access related issues that impact the copyright industries directly and that must dealt with during accession negotiations. Many of our members filed separate submissions and will provide greater detail on this overall subject.

IIPA strongly favors a zero tariff on computer software. Such treatment reduces the incentive to pirate software and encourages computer literacy and productivity. However, Chile continues to impose a duty -- at an 11% level -- on computer software and assesses it on the value of the software package's content, not just the value of the physical media. All but a few countries around the world assess customs duty on software based on the value of the media in recognition of the services nature of intellectual property. This technique is favored by most of Chile's trading partners including the United States, Canada, Mexico, Brazil and the countries of the European Union. Assessment on the value of the content

raises the price of computer software in the Chilean market substantially more than would assessment on the value of the media, thereby encouraging piracy.

2. The "Cultural Industries" Exemption

Perhaps the most important issue relates to the provisions of the NAFTA that permit a derogation to Canada through the extension to NAFTA of the "cultural industries" exemption found in the Canadian Free Trade Agreement. This exemption was reluctantly acceded to by the U.S. and may permit Canada, without violating its NAFTA obligations, to take a derogation from its NAFTA intellectual property obligations (except those deriving from Canada's adherence to other international agreements, such as the Berne Convention and TRIPS) as well as from obligations under the Services and Investment texts, to the extent they relate to "cultural industries," as defined in Annex 2106 of the NAFTA and Article 2012 of the U.S.-Canada FTA.

IIPA strongly opposes extension of the cultural industries exemption to Chile or to any other country in Latin America. As has been emphasized repeatedly by IIPA and by the MPAA, RIAA, AAP, NMPA and other members in the past, this so-called exemption has often been cited by other countries as justification for imposing protectionist restrictions on U.S. companies. While the United States reserved its right to retaliate if Canada should implement this derogation, this is not an acceptable solution.

The United States should use the opportunity offered by the opening of protocol discussions to reengage with Canada on mutual concerns regarding cultural issues and on trade in cultural products. The United States and Canada should make every effort to seek the elimination of this broad derogation in favor of known rules of conduct.

C. Conclusion

The extension to Chile of an FTA containing high levels of intellectual property protection and enforcement and thereafter to other countries in the Hemisphere is a high priority for the intellectual property industries. The standards of protection outlined in this submission will not only increase investment by the copyright industries, produce increased exports and provide high-wage jobs and revenues for American workers and companies, but will significantly benefit high technology and cultural development in each country's domestic economy.

We urge the Administration to press forward this agenda with deliberate speed and to maintain the momentum of trade liberalization spurred by NAFTA and the signing of the WTO.

Sincerely,

/s/

Eric H. Smith
President

Attachment

APPENDIX A

IIPA Summary
of Major NAFTA and TRIPS Deficiencies in
Chile's Copyright Law

Computer Programs as "Literary Works": While computer programs are protected under copyright, they are not expressly protected as "literary works" as required by NAFTA Article 1705(1)(a) and TRIPS Article 10.

Databases, Compilations and New Works: Protection for compilations of unprotected facts under the Chilean copyright law is unclear. NAFTA Article 1705(1)(b) and TRIPS Article 10 requires protection of compilations of data or other material. Furthermore, IIPA recommends that the list of protected subject matter should be expanded to protect any original work now known or later developed.

Rental Rights for Computer Programs: A non-exhaustible rental right for computer programs is missing from the Chilean law. NAFTA Article 1705(2)(d) and TRIPS Article 11 requires that the commercial rental of the original or a copy of a computer program be provided.

Rental Rights for Producers of Sound Recordings: While the copyright law does provide producers of sound recordings with a rental right, it is not clear whether this right is non-exhaustible, as required by NAFTA Article 1706 and TRIPS Article 14(4).

Right of Piratical Importation: The copyright law does not provide authors or producers of sound recordings with an express right to authorize or prohibit the importation of copies of the works or sound recordings made without the author's or producer's authorization, as required by NAFTA Articles 1705(2)(a) and 1706(1)(b). Instead, the law provides penalties for "those who, contrary to the provisions of this Law or to the rights protected by it, intervene with gainful intent in the ... introduction into the country of ... phonograms, videograms, phonographic discs, cassettes, videocassettes, films or cinematographic films, or computer programs..." An exclusive importation right for authors of all works and producers should be expressly provided in the rights section of the law, to deal at least with importation of pirate copies, and preferably, with parallel importation as well.

Performance and Broadcast Rights in Sound Recordings: While the Chilean law creates a right in the producer of a sound recording to publicly perform/broadcast/communicate its work, the law also ties this right to exercise of these rights by the author of the underlying musical composition. The rights of the record producer should be independent of and parallel to the right of an author as pertains with all other exploitation rights.

Contracts and Work-Made-for-Hire: It is essential that the process of assigning ownership of initial economic rights be unambiguous and that transfer of rights be fully subject to voluntary contracts subject to market forces. NAFTA Article 1705(3) establishes an obligation to permit free and unhindered transfer of rights by contracts. The Chilean law provides for certain specific percentages regarding remuneration for publishing contracts and public performances of works; these percentages must be left to contractual negotiations between the parties.

Encrypted Program-Carrying Satellite Signals: NAFTA Article 1707 requires that Chile amend its law to make it a criminal offense to manufacture, import, sell, lease or other make available equipment for decoding encrypted satellite signals. NAFTA also requires that civil actions for injunctive relief and damages can be brought for those programs or signals which have been unlawfully distributed. These protections must be added to the Chilean law.

Exceptions to Protection: NAFTA Article 1705(5) and TRIPS Article 13 restate the Berne Article 9(2) provision regarding exceptions to protection for works. The current law contains overbroad exceptions regarding the use of photographs which are incompatible with the Berne Convention and should be deleted. Moreover, the general exception for private copying for personal use must be circumscribed to meet the NAFTA/TRIPS test. Under NAFTA, Article 1706(3) sound recordings are also made subject to the limitations of Berne Article 9(2).

Definition of "Public": NAFTA Article 1721 contains an explicit definition of the term "public" which should be included in the copyright law.

Waiver of Moral Rights: IIPA recommends that the author should be able to waive moral rights; this is critical in order for the owner of the economic rights to be able to finance and market the work.

Criminal Penalties: NAFTA Article 1717(1) and TRIPS Article 61 require criminal procedures and penalties "to be applied" in cases of "copyright piracy on a commercial scale." These penalties must include imprisonment or monetary fines, or both, "sufficient to provide a deterrent." The current level of criminal penalties in the Chilean copyright law is low and inadequate to effectively deter piracy. We understand that criminal sanctions for infringement are only 61 to 540 days in prison and a fine ranging from 5 to 50 monthly tax units (approximately $200 to $2000). These penalties must be significantly increased and actually imposed in order to deter piracy in Chile.

Ex Parte Searches: NAFTA Articles 1715 and 1716 outlines specific civil, administrative and provisional measures, including ex parte search orders. While civil ex parte searches reportedly are available under the Chilean civil code, U.S. software companies report difficulties in using the civil code in copyright infringement cases. Typically software publishers must request the opposing party's permission to make an inspection; this clearly undermines the "surprise" nature of the search, especially when evidence of software infringement can disappear with the touch of a button. In addition, the software industry reports that judges frequently refuse to issue search orders against corporate users.

Enforcement Measures Generally: It is imperative that Chile meet all of the enforcement provisions in NAFTA Articles 1714-1717 as well as border enforcement measures in Article 1718 (also found in TRIPS Part III on Enforcement). The Chilean copyright law contains few specific provisions regarding these measures.

PREPARED STATEMENT

INTERNATIONAL LABOR RIGHTS FUND
110 Maryland Avenue NE, Box 74
Washington, DC 20002
Pharis J. Harvey, Executive Director

to

WAYS AND MEANS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

JULY 13, 1995

"CHILE'S ACCESSION TO NAFTA"

The International Labor Rights Fund is a non-profit organization that focuses its work on issues of workers' rights in the international economy, particularly with respect to trade policies at the national, regional, and global levels. In the month of June, ILRF sent a researcher[1] to Chile to investigate the Labor Code and labor conditions. To this end, she interviewed workers, unionists, government officials, labor lawyers and advisors, and members of non-governmental organizations.

The Chilean government has made minimal changes to the labor code that the Pinochet military dictatorship imposed in 1979 and modified in 1987. Chile has not ratified the basic ILO Conventions (with the exception of Convention 111 regarding non-discrimination) and has particular problems with the right of collective negotiation, the right to strike, and, in some sectors, with unsafe and unfit working conditions. Current prospects for meaningful reform are dim, especially since Pinochet personally designates and controls the votes of nine of the 36 members of the Chilean Senate.

Much of Chile's recent economic policy has been concerned with fostering trade and export-oriented growth. In light of the fact that this emphasis has not been conducive to an improvement in worker living standards, and has arguably been quite detrimental, it is most unlikely that a rapid accession to NAFTA will in itself rectify Chile's labor problems. Chile's accession to NAFTA should be postponed until Chile makes substantial changes in its labor laws, or until the NAFTA institutions are empowered to address labor issues on the basis of international standards rather than the current standard of "national enforcement of national law."

I. THE LABOR CODE: A BRIEF HISTORY

A recent comic in Chile's largest daily newspaper, El Mercurio, showed two men standing in the rain in front of an enormous hole, their walk down the highway stymied. "This is like the road to reconciliation," explains one to the other, "paved, but...". The comic was referring explicitly to the stalemate between the government and the military in the weeks following the Chilean Supreme Court's decision to uphold the sentences of Generals Espinoza and Contreras for orchestrating the 1976 murder of Ambassador to the U.S. Orlando Letelier. However, this image of flawed construction and localized pitfalls is apt for other aspects of Chile's situation. The Chilean worker has fallen through the cracks of Chile's 'economic miracle.'

In 1931, Chile promulgated a progressive labor code that prevailed until the military coup of 1973. The code included strong tripartite participation in the negotiation process and was responsible for generating a relatively equitable income distribution, one of the best in Latin America. Collective bargaining conflicts were settled through labor courts and tribunals consisting of workers, owners, and the government. More than one third of Chilean workers were union members at the time of the coup.

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[1]Rachel Geman, Columbia University School of Law

In 1973, Pinochet initiated a reign of terror against organized labor in which an estimated 2,200 union leaders were fired, 110 killed, and 230 jailed in the immediate aftermath of the coup.[2]"I was lucky,"explained Edmundo Lillo, president of the National Federation of Commercial Workers, "because I was only detained in my house for five days while I waited to see what would happen." "I was jailed and tortured," said the president of a vineworkers union, "and after that I was pretty quiet for a few years and did my work." Many other unionists were exiled in the years that followed. To this day the union leaders disappeared and killed under the military regime are listed and commemorated in reports from labor meetings.Although some unions went underground, most disappeared under state pressure. Today 80 percent of Chile's unions are less than 15 years old.

In light of the above, it is ironic that when the Pinochet regime did set out to decree a labor code in 1979, it took great steps to curtail the "power" of labor. Under this code, an employer could fire an employee for any reason (or for no reason), unilaterally modify the workday, and withhold essentially all information on its workers from the Direccion del Trabajo (the Labor Department). The code set a rigid schedule for collective bargaining based on the first initial of the name of the company. Although unions in which members could vote for their own representatives reemerged in 1980, workers remained powerless to affect their labor conditions. The drastic 1979 revision was followed by the eradication of the minimum wage in 1982 and the passage of the modified labor code of 1987 which dealt with further "rigidities" of the labor system. The 1987 code, inter alia, banned negotiations across companies and limited strikes to 60 days. Because of restrictions such as these, President Reagan removed Chile from the list of Generalized System of Preferences (GSP) countries.

Between 1990 and 1994, the government of Patricio Aylwin passed a number of reforms, but their limited nature reflects the lack of political will to enact substantive change. Employers must give a reason to fire employees, but the"needs of the company"(which can arise due to anything from a drop in productivity to a change in the economy) is an adequate reason. Employers have only the most basic responsibilities to their employees. They do not have to pay any health or social security, and in 1991 the law set a maximum severance pay of 11 month's salary (before the coup, a worker would receive a month's pay for every year worked). This limitation worsens the plight of the increasing numbers of those without social security. An International Labour Organization study on the effects of NAFTA found that an incredible 80 percent of rural farmworkers do not pay into the pension system, and therefore can expect no adequate retirement income.[3] (This study has been ready for publication for quite some time but the Chilean government has been holding onto it for "comment," and the release is delayed.)

Limitations on collective bargaining are severe. Aylwin reforms allowed for the establishment of centralized unions in the form of federations and confederations. These organs may not, however, act as bargaining agents, and must serve only advisory and supportive roles. The bargaining function is constricted through being limited to company-level unions. (Small inter-company unions are allowed to form but employers are under no obligation to negotiate with them. A recent and highly-discussed study by the Ministry of Labor found that negotiations involving more than one company occur only 0.4 percent of the time.[4]) Other labor fragmentation is also rooted in the law. The same chain of stores of businesses may get a series of "razones sociales" (business licences) and thus be considered a series of different companies--requiring different unions--under the law. The average size of a union is 62 people, and employers often try to foster labor conflict by offering smaller or more 'tractable' unions better benefits.

According to Pablo Lazo of the Ministry of Labor, only 30 percent of the Chilean workforce could bargain even in theory. The growing informal sector is neither recognized nor organized. In direct violation of International Labour Organization Section 87 on the Right to Organize, Article 305 of Chile's labor code states that temporary or transitional workers and workers contracting for a fixed

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[2]See, e.g., Collins, Chile's Free Market Miracle: A Second Look (1995), 70.

[3]Briefing from the ILO's Emilio Klein in the Santiago Office.

[4]Ministerio del Trabajo y Prevision Social, Informe Final: Investigacion de Normas Laborales, Negociacion Colectiva y Organizaciones Sindicales (1995), 4.

project (in other words, temporary farm workers, port workers, construction workers, forestry workers, and anybody whose work can be construed to be for a fixed length of time), public employees, and anybody labeled a 'supervisor' cannot engage in collective negotiation. Hence, in key and growing areas of the Chilean economy, workers are barred from reaping the benefits of the single most fundamental capacity of unions. This renders useless their membership in unions. The result is that the internationally-recognized right of free labor association is effectively denied to huge portions of the Chilean workforce.

In the face of considerable international criticism, the government repealed the 60-day limit on strikes. However, other mechanisms exist to put severe limitations on the right to strike. Perhaps foremost among these is the use of replacement workers. The Chilean government's "Chile Information Handbook," written to inform the U.S. House and Senate about Chile's suitability for NAFTA accession, states somewhat vaguely that "[r]eplacement workers can be hired [] under certain requisites."[5] What is not said explicitly is that replacement workers can come in on the first day of a strike if the employer's last offer did not decrease the salary, and after 15 days if the last offer did entail a salary reduction. Replacement workers are allowed in the United States as well, but the difference is that the use of the strike in Chile is very heavily regulated and strikes are only allowed during collective negotiation periods, even if the employer is engaging in unfair labor practices in the interim. The consequence of all this is that strikes have been rendered useless as a device for raising workforce living standards.

On January 11, 1995 President Eduardo Frei introduced new labor law reforms to Chile's House of Deputies (lower house). These reforms, although "modest" (to quote the *Economist* magazine[6]), are extremely unlikely to pass, but an understanding of both why they are insufficient and why they will not pass will be postponed to the last section, after the discussion of the labor code in context.

II. LABOR CONTEXT

A. ORGANIZED LABOR

About ten percent of Chilean workers are members of unions. A new union can form at any time and bargain with the employer, but the employer may have 60 black-out days with which to preclude the first negotiation. The pressures against joining a union are considerable. Employers foster the notion that only communists become members. All but one of the union representatives with whom the researcher spoke bemoaned the common employer practice of threatening retaliation to workers who are considering joining a union. Many workers are fired for attempting to create unions. The labor code does not affirmatively state that this is illegal, although the code does incldue the general provision that nobody can be impeded from joining a union. Current law affords no sanction for firing due to union activity. One of the proposed reforms would fine employers for this practice, but prospects for its passage are as speculative as for the rest.

The collective negotiation process is a time fraught with peril and anxiety for union members. The Ministry of Labor study cited above demonstrated what was well-known: that more people are fired right before and right after collective negotiation than at other times. Unions are not entitled to the sort of company data, such as information on productivity, that can inform the bargaining process. Finally, there is no "ley de piso" (law of the floor), no guarantee that workers will maintain what they had. Although it is increasingly true that U.S. workers are accepting reductions in benefits and wages as alternatives to downsizing, they begin with much more. For example, the minimum wage in Chile is 59,000 pesos (about U.S. $150) per month for the 48-hour workweek--less than a dollar an hour, and workers do not in general receive health benefits from their employers. Miguel Soto, President of the confederation of metallurgic workers CONSTRAMET, gave an example of a company offer.

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[5]Chile Information Handbook, Section Four- Page 4.

[6]An article from El Mercurio on June 21, 1995 described a speech that the Minister of Economics, Alvaro Garcia, made in which he refuted the charge levied by AmCham and other employer organizations that labor reforms would hurt Chile's receipt of foreign investments. He said that *The Economist* characterized the reforms as modest and an efficient and cheap way to refortify the political consensus.

The union of the company Eulogio Gordo was going to go on strike. Their only demand during the entire negotiation had been to maintain their wages (of about $250 per month) and to index their future wages to the consumer price index. The company wanted to reduce wages by 25 percent. In Chile, 1994 numbers revealed that only 25.5 percent of final offers from employers entailed an increase in real wages, 44.3 percent kept wages the same, and a full 30.2 percent offered less.[7]

Unions can only strike during the negotiation process, under conditions that are heavily regulated. The strike must be voted on in the last five days of negotiation, and if passed it must be carried out within three days. Strikes are times of both mass firings and mass union exodus. Recently, 350 administrative workers in a union went on strike. The strike ended after 25 days, and by the thirtieth day only 40 members remained in the union. A little more than a year ago, agricultural workers in the company Jose Celsie Llobe went on a three-day strike during which 67 of the 125 unions members were fired.

Finally, in spite of International Labour Organization norms on the integrity of the collective bargaining contract, Chilean law allows the results of collective bargaining to be undercut. The tenure of a collective contract in Chile is two years at the minimum. However, an employer or employee can displace the contract with a "convenio"(pact or covenant)[8] for individuals or groups of workers. The convenio replaces whatever contract or convenio that preceded it. The use of convenios further fragments and atomizes the workers. None of the rights surrounding the collective negotiation process, such as the right to strike, apply to the convenio process. Both employers and employees can technically prompt the process of creating a convenio, but most convenios are pre-made, non-negotiable instruments which the employer offers, telling workers that it is in their best interest to accept them. This practice is in sharp contrast with U.S. labor law, in which a variance from the collective bargaining agreement cannot be offered to union members without the permission of the union.

Unions in Chile are small, young, under informed, mistrusted, and undermined. As the above discussion should demonstrate, Chilean labor law and labor law enforcement are inadequate to safeguard their interests. The consequences are manifold. Unions by and large cannot sustain strikes or threaten strong strikes in order to win higher living standards. For this reason, alongside employer defiance of laws protecting union activity from employer reprisal, unions cannot attract broad memebrship.This means that the organized political voice of labor is drastically weak, so that policy decisions unfairly slight the interests of working people. Worse, this weakness of organized labor may be deliberate. A development strategy totally geared toward the export of primary commodities requires and perpetuates a harshly low-wage regime for millions of workers. It is questionable whether such a regime is worthy of partnership in U.S. global trade initiatives.

B. UNORGANIZED LABOR AND WORKING CONDITIONS

The roughly 90 percent of workers who are not members of unions rely on general labor and employment laws to safeguard their needs. Many of the rules are sidestepped and disregarded. For example, employers tend to set up work and payment by project rather than hour, and workers lose breaks and go home late in their efforts to finish up. A baker's shift consists of preparing two 50 kilo bags of grain into bread, and because each employee is responsible for his or her supply of grain any break would interrupt the flow of the baking process. Textile workers are often paid by garment made (although in the section Patronado, in which 600 small shops line the streets, the few men who work in the sweatshops are given a fixed wage whereas the women work solely by unit). Agricultural workers in the packing season often cannot leave work until they have packed all of whatever product is in the storage area into boxes.

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[7]Ministerio del Trabajo, 19.

[8]Article 351 of the Labor Code states that a collective convenio is between one or more employers and one or more unions or negotiating groups united for this end, with the objective of establishing working conditions and remunerations for a fixed time, without subjugation to the procedural norms, rights, or obligations of collective negotiation.

According to a 1994 study *Mercado de Trabajo Flexible, Pobreza y Desintegracion Social en Chile*[9], at least 38 percent of workers work more than eight hours a day and the number of people who work longer than the 48-hour workweek is growing.[10] (The grassroots organization Red Chile para Una Iniciativa de los Pueblos [RECHIP] notes that more than 200,000 Chilean workers suffer from chronic fatigue.) The study also found that 13.2 percent of workers earned less than the minimum wage, and another 45.5 percent earned less than double the minimum wage, which according to the authors is the amount of money necessary to cover basic needs.[11]

Manuel Ahumada, president of a confederation of food workers, explains that in at least some sectors, workers are pressured by employers to waive their rights. He has helped unions of supermarket employees to lodge complaints against management for the practice of physically inspecting workers upon departure from the store. According to Ahumada, it is not unusual for employers to plant goods on employee's belongings and have the employee sent to jail for putative theft, where the worker loses in the battle of his or her word against the company's. Employees are released only after they waive some of their rights, such as their vacation.

Although workers can lodge complaints of infractions with the Direccion del Trabajo (the Labor Department), enforcement is hindered by the office's low budget and slow response. When temporary agricultural workers complained that they had to go into the fields right after pesticide was sprayed, they were told by the Direccion that none of the inspectors had access to the sort of vehicle that could drive into the fields to ascertain the veracity of the complaint.

To reiterate, most workers cannot even utilize collective negotiation as a resource because Chilean law does not allow temporary or transitional workers, construction workers, port workers, forestry workers, and public sector employees to engage in collective negotiation. One can work in the fields for 20 years and still be a temporary because the job does not last all year, and one can work on the same construction project for ten years and still have no contract because the job is considered discrete and temporary. There is also a considerable informal sector in Chile--young men who jump on and off Santiago's 20,000 buses selling candy, older men who sell unusual amalgams of cheap products on the street, earning $12.50 a day on a "good day" and working seven days a week--which is not even acknowledged by the labor code let alone protected.

The situation of the temporary farm workers is particularly important because it is a sector that came about under Pinochet's policy of exporting natural resources and non-value added products, such as fruit. In spite of the current agricultural crisis due to the fall of the dollar, there is near universal consensus that the fruit export sector would grow after the passage of NAFTA, and that workers displaced from traditional sector agriculture such as wheat and rice could be absorbed into the temporary fruit market.

In Chile there are about 250,000 temporary workers in the fruit industry alone and as many as 650,000 temporary agricultural workers in total. Most of the temporary fruit workers are women. They work for four to five months of the year, harvesting, picking, and packing. Some workers have informal work during the off-season such as clipping branches, but most must eke a year's subsistence out about 18 week's wages.

The hours of the temporary workers are brutal. Employers are supposed to provide

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[9]Agacino and Leiva, 53.

[10]The ILO has issued statements on the subject of working hours in Chile and has concluded that the practice of allowing two extra work hours on the eight-hour workday (with overtime) is conducive to abuse because the law sets no limit on the annual amount of overtime that one can work.(See CEARC: Individual Observation concerning Convention No. 1, Hours of Work, Published 1993, ILO Classification 04-02-01.)

[11]Ibid.

transportation to the fields by bus if employees live more than 1.5 kilometers away from the worksite. Instead, workers have to crowd onto tightly-packed tractors and small trucks. During the busy packing season, 14-18 hour days are common. Children are hired to pack and carry smaller boxes. Most of them begin working at age eight or nine, and are in the fields by age 12. Employers have been known to force their employees to take stimulants to stay awake for the long shifts. The workday in the fields is also long and poses other dangers: not only are toxic pesticides used, but workers are not given adequate protective clothing and often must work just after fields are sprayed. Some repercussions of this exposure to toxic chemicals are birth defects, and one study[12] has found that three times as many babies were born with birth defects in a hospital in the farming area of Rancagua than in the University of Santiago clinical hospital. The controlled numbers are probably even more pronounced because most of the women in the Rancagua hospital were young and because Santiago is a speciality hospital which deals with problematic pregnancies.

The temporary workers mostly live in small *poblaciones*, or villages. Roofs barely cover the small houses, roads are rarely paved, and amenities such as telephones and washing machines are practically nonexistent. Children take care of other children because parents must work.

A temporary farm worker would have to work three years to earn what a member of the Chilean congress earns in one month.

III. THE NAFTA CONTEXT

Chilean labor law is inadequate in the basic labor areas of association, collective negotiation, and the right to strike. Under the Labor Side Agreement, none of these areas are amenable to NAFTA enforcement action. Additional problems abound in the agricultural sector, including child labor and the use of toxic pesticides. President Frei has proposed a series of labor reforms. These reforms would require a majority in the House of Deputies (the lower house) and in the Senate to pass. Some of the reforms are quite modest (such as extending the length of collective negotiation by five days), others are considerable (such as allowing temporary workers to organize and eliminating the use of replacement workers). Five out of the 13 Deputies have voted against even the idea of reform, but the major problem for the proposal will be with the Senate, where anti-reform forces are strong in spite of the Concertacion's (the coalition group of political parties that has been in power since the end of the dictatorship) electoral majority. According to Mario Velasquez of the Ministry of Labor, a majority plus two of the Senate has explicitly stated that they are opposed to labor reform. Mr. Velasquez believes that at most some of the modest reforms will pass during conference committee.

Government need not be the only avenue of reform in a society. However, in the case of Chile, other societal actors seem unwilling or unable to foster a climate of reform. The weakness of Chilean labor has already been discussed. Chilean employers have demonstrated a myopia in their dealings with their workforce. For example, they utilize less than one third of resources allotted by the government for skills training in a program through which a company spends one percent of its budget on training and then gets reimbursed. As one farmworker explained, "if they [the fruit companies] could pay us one thousand pesos [about $2.50] a month they would...they have no sense that this would have effects, that anything that affects us could affect them. It's not as though they pay for our health or help with our future."

And what of U.S. corporations in Chile? Globalization would ideally encourage a harmonization and augmentation of standards. Regrettably, U.S. corporations in Chile seem indistinguishable from their national counterparts. As Arnoldo Montoya, president of General Electric's Santiago union wryly noted, GE is run "a la Chilena," which means that it is characterized by antagonism toward workers and grudging compliance--when there is compliance at all--with rules. There are small problems, such as a space for changing in and out of work clothes that is small and uncomfortable, there are unconscionable price-saving measures such as lack of adequate protective gear in dealing with machines which use Mercury, and there is flagrant disregard of rules. Four years

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[12]When I visited the Federacion Campesina Bernardo O'Higgins in Rancagua, I was told about Dr. Victoria Mella's survey by the dirigentes; see also reference in The Toronto Star (May 27, 1995).

ago workers were involved in a dispute with management because many of the employees were working up to 15 days without a break. Many were fired after complaining to the Direccion del Trabajo.The Direccion gave GE six months to improve. As a form of de facto punishment for having complained, GE set up a schedule whereby people had a day off, but rarely was it Sunday. After productivity dropped the company slowly returned to giving Sundays off.

General Electric is not atypical among American operations in Chile. Manuel Ahumada noted that working conditions in MacDonalds and the Hyatt were no better than in the local establishments. Workers picking fruit for Dole are not better off than those picking for Chilean companies such as David del Curto and UTC. In fact, many temporary workers do not even know for whom they are working because of subcontracting and because any questions are regarded suspiciously. U.S. companies seem as unlikely as Chilean companies to improve the labor conditions unilaterally.

Chile's NAFTA accession raises questions about whether and under what conditions an extension of NAFTA will improve labor rights. It is clear that the increased trade under the Pinochet regime did not lead to an improvement in labor or working conditions. On the contrary, it served to create an impoverished sector of temporary wage earners. The *poblaciones* described above did not exist until 1976. There are at least as many temporary agricultural workers as there are organized workers in Chile. Pinochet's economic policies also displaced many industrial workers into minimum-wage jobs, the informal sector, and unemployment. Between 1979 and 1982, over 20 percent of Chilean manufacturing companies went under.[13] It is not adequate to argue that the economies change, that there are always winners and losers, that a rising tide lifts all boats. Chilean workers (whose unemployment in the years 1974-1987 averaged 20 percent) have been repeat losers since 1973. There is no reason to assume that they will fare better under NAFTA than they did under Pinochet's trade policies.

If the labor reforms under current consideration--especially those allowing collective negotiation for temporary workers, banning the use of replacement workers for unfair labor practice strikes, and proclaiming the right not to be fired for creating a union--were enacted, this would go a long way toward bringing Chilean labor law in line with the United States, Canada, and Mexico's. If they do not pass, Chilean workers would be at a disadvantage in terms of both law and practice. Because of NAFTA's "national enforcement of national law" treatment of many of the areas most problematic in Chile, Chile would be held to a much lower standard than the other three signatories. As Paula Stern, former Chairwoman of the U.S. International Trade Commission, pointed out in her testimony on fast track, the oppositional attitude toward the inclusion of labor and environmental objectives in the NAFTA debate is "puzzling [since] fast-track laws passed in 1974 and 1988 included labor rights among their negotiating objectives...a politically sustainble trade policy requires support from all commercial interests."[14] The United States must not deviate from its longstanding international practice. It must not conclude free trade negotiations with Chile until Chile brings its labor laws in line with internationally-accepted norms.

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[13]Collins, 73.

[14]Written Statement of Paula Stern to the Ways & Means Committee, ▒Fast Track to a Trade Architecture to Sustain U.S. Economic Prosperity and Global Leadership▒ (May 11, 1995), 16.

Subject to approval by the Chairman

STATEMENT OF
DR. RICHARD L. BERNAL
AMBASSADOR FROM JAMAICA TO THE UNITED STATES

BEFORE THE
HOUSE WAYS AND MEANS TRADE SUBCOMMITTEE

JULY 13, 1995

CHILE'S ACCESSION TO THE NAFTA

Mr. Chairman, thank you for providing me this opportunity to submit testimony before your Subcommittee on Chile's bid to join the NAFTA. As the Subcommittee moves forward with its review of this development -- which will have a far-reaching impact on trade relations throughout Latin America and the Caribbean -- I believe it is important to provide you with a Jamaican perspective on some of the issues surrounding Chile's accession.

A. Chile and The March to 2005

Last December, the 34 Democratically elected nations of the Hemisphere came together in Miami to hammer out an agreement to launch a Free Trade Area of the Americas (FTAA) by the year 2005. Last month, the trade ministers of those countries convened in Denver to determine how to take the next steps in this important goal.

The relative speed with which Chile has already commenced active negotiations with the NAFTA partners, is a heartening indication of the momentum behind the FTAA process. If the NAFTA was the first step in the road toward Hemispheric free trade, then Chile's accession can indeed be seen as a solid second step. Hopefully, this path will converge with other paths now being forged toward the goal of free trade by other countries such as those constituting CARICOM, Mercosur, and the Andean pact -- to name a few.

B. The US/Caribbean Trade Relationship

In the dozen years since it has been enacted, the Caribbean Basin Initiative (CBI) has emerged as an important stimulus of economic development in the Caribbean Basin and of trade linkages throughout the region. The effect has been felt -- not only in Kingston and Montego Bay -- but also in Chicago, Miami, Baltimore, New York, and hundreds of other communities throughout the United States. Through its combination of trade, investment, and tax policies, the CBI legislation has progressively established a framework that has facilitated mutually beneficial, U.S./Caribbean economic links. In turn, Jamaica and other Caribbean countries have matched the liberalizing reforms enacted by the CBI to launch their own trade and investment economic reform programs. Together, the United States and Caribbean countries have created a trade partnership worth more than $20 billion a year, employing hundreds of thousands of workers throughout the region.

The successes of the CBI legislation are reflected in the figures signalling robust growth in the U.S./Caribbean trade partnership. Since the mid-1980's, U.S. overall exports to the Caribbean have expanded by over 100 percent and Caribbean exports to the United States have climbed by roughly 50 percent. The Caribbean Basin now comprises the tenth largest market for the United States, and is one of the few regions where the United States consistently posts a trade surplus. With combined trade exceeding $24 billion in 1994, U.S./Caribbean commercial links support more than 265,000 jobs in the United States and countless more throughout the Caribbean and Central America. During the past decade, nearly 16,000 American jobs have been created each year as U.S. trade links with the Caribbean have expanded. Throughout the

Caribbean, where the economies are much more dependent upon trade, increased exports to the United States has generated hundreds of thousands of additional jobs. Such employment growth has been felt in both export industries, as well as in the many sectors that cater to these industries.

C. NAFTA's Future and the Caribbean

Jamaica is observing the debate surrounding Chile' s accession with great interest for several reasons:

First, we would hope that, as the Congress considers Chile's bid to join the NAFTA, it also take into account US trade relations with the Caribbean and how those relations may be affected by Chile's entry into NAFTA. As you know, the successes of the CBI are already being eroded inadvertently because of preferential access to the US market granted to Mexico under the NAFTA. Already, trade statistics have documented a diversion of trade and investment from CBI countries to Mexico. If this disruption persists, business confidence in the Caribbean region could be permanently injured. In much the same way, Chile's accession to the NAFTA has the potential to exacerbate this disruption.

It is in this context, that Jamaica supports The Caribbean Basin Trade Security Act (HR 553), which has been adopted by this Subcommittee, as a means of directing attention to the US/Caribbean relationship. Specifically, Jamaica heartily endorses Section 202(c) of that bill, which requires the Administration to submit a "parity review" in the event that another country joins the NAFTA. In the event that the Administration determines that a future NAFTA partner could adversely affect US/Caribbean trade linkages, the USTR is then required to submit proposals to minimize this adverse impact. Such a provision is a key element of the parity debate, since it fosters a continual vigilance of the US/Caribbean trade relationship on the part of the Administration.

Second, Chile's accession gives rise to an obvious question concerning what happens in the NAFTA accession process after Chile joins the NAFTA. In a very real sense, who's next? Jamaica believes that it is not too early to begin addressing this question by at least establishing a dialogue to determine how the next NAFTA partners may be chosen. This is particularly key given the deadline established by Section 108 of the NAFTA Implementing Act, which requires the President to identify likely NAFTA partners by July 1, 1997. Although future NAFTA accession may be overtaken by events surrounding the FTAA process, a clear and consistent set of guidelines for NAFTA accession will also strengthen the understanding of free trade obligations throughout the hemisphere.

A concern that is shared in Jamaica and in other parts of the Caribbean is that the NAFTA expansion will focus exclusively on those countries which present the biggest markets -- the so-called "Big Emerging Markets" -- for the United States. While the prospect of a large market might be appealing, I would respectfully point to several other factors that could ease future NAFTA accessions. First, given the contentious debate surrounding the NAFTA, and the concerns that have arisen regarding the Chile accession, it may be logical to look to countries that have already achieved many of the NAFTA trade liberalizing principles and criteria. If a large market has a long way to go before achieving may of the NAFTA disciplines, it may be too large for NAFTA to digest.

Attention must be focused on those countries that are complementary to the NAFTA markets. Such countries, especially those with smaller economies, could "fit" well with the NAFTA, providing the least competitive friction (and disruption) to industries in the NAFTA countries. Choosing a smaller economy could also signal other small economies throughout the Hemisphere that the free trade process is inclusive. In her testimony on

Chile's accession to the NAFTA, Ambassador Charlene Barshefsky pointed to Chile as a psychological and tangible link bridge between NAFTA and the Mercosur countries. In the same manner, accession of a Caribbean country to the NAFTA would provide an important link to the rest of CARICOM and the CBI countries.

D. Jamaica's readiness for free trade

In that context, ***Jamaica is deeply committed to an open multilateral trading system is a stimulant to economic growth,*** both through the static gains from increased efficiency in the utilization of its existing resources and the dynamic gains from the opportunities to expand productive capacity through new technology, investment, and innovative entrepreneurship.

Jamaica is an advocate of trade liberalization within the hemisphere and of a multilateral trading system that approaches free trade as far as possible. Jamaica subscribes to, and its policy has always been fully consistent with, the principles and disciplines of the GATT. Jamaica joined the GATT in the early 1960's and has been an active participant in, and has contributed to, successive negotiating rounds aimed at further liberalization of global trade.

Moreover, Jamaica actively participates in several regional trade-liberalization arrangements with the United States (the Caribbean Basin Initiative -- CBI), Europe (the LOME Convention), Canada (CARIBCAN), and the other English speaking countries in the Caribbean (the Caribbean Common Market - CARICOM). All of these arrangements are intended to promote trade between the member countries. Finally, Jamaica also has supported the creation of free trade within the Western Hemisphere using the North American Free Trade Area (NAFTA) as a first building block of free trade within the hemisphere.

Jamaica realizes that there is now a new phase of globalization of production and finance which is rapidly sweeping away national barriers to the movement of goods, services, capital, and finance. During the 1980's, Jamaica's economic policies focused on economic reform, stabilization, and structural adjustment in an attempt to create an environment conducive to a private sector-led, market-driven, outward-looking growth strategy. An important aspect has been a comprehensive program of trade liberalization involving substantially reduced tariffs and the elimination of quantitative trade restrictions. This has been complemented by freeing market forces within the domestic economy through the abolition of price and exchange controls by a vigorously implemented campaign of privatization and fiscal and monetary discipline. A stable, market-determined exchange rate system is operating successfully, preventing any disruptive changes in the value of the Jamaican dollar.

In the last four years there has been a substantial acceleration in the process of liberalizing the trade regime of Jamaica, with an emphasis on the removal of import restrictions and the lowering of tariffs. In many ways, US products in the Jamaican market are accorded better access than Jamaican products in the US market because Jamaica does not rely upon quotas as a tool of trade policy. Jamaican sugar and apparel products, for example, still face US quotas.

This commitment to outward-looking trade and development policies is firmly based on the knowledge that the benefits to be derived are those of higher growth rates and enhanced capacity to adjust to external shocks. Expanding trade contributes to Jamaica's growth by enabling the economy to improve its productivity by specializing in exports in which it has a comparative advantage. Production for the world market allows firms to achieve the economies of scale which are precluded by a small domestic market. Exposure to competition from imports serves to

improve cost efficiency and benefits consumers by lower prices.

Jamaica now sees the CBI program as a springboard to greater hemispheric free trade liberalization. In many cases, we have already taken steps that exceed the requirements of the CBI to help accelerate this goal. ***Jamaica has already signed both a bilateral investment treaty (BIT) and an intellectual property rights (IPR) agreement with the United States. We were also one of the first countries to include new anti-circumvention language in our bilateral textile agreement with the United States.***

Jamaica is ready and has a demonstrated commitment to enter the next stage of trade liberalization with the United States -- that of negotiating a free and reciprocal trade agreement.

E Conclusion

Chile's imminent membership in NAFTA is a welcome development that provides a tangible boost to the prospects of free trade in the hemisphere. Care must be taken, however, that the expansion of NAFTA is not carried out at the expense of other established trading relationships in the region. The United States and the Caribbean have enjoyed an intimate, and mutually beneficial, trading relationship for the past twelve years. With proper attention, this relationship can be strengthened and expanded in the coming decade as well.

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Before the:

International Trade Subcommittee
Committee on Ways and Means

ACCESSION OF CHILE TO THE
NORTH AMERICAN FREE TRADE AGREEMENT

Comments of Libbey Inc.

July 13, 1995

These written comments are filed on behalf of Libbey Inc. in response to the notice of the Ways and Means Committee, International Trade Subcommittee, concerning Chile's possible accession to the NAFTA.

Libbey is a leading U.S. manufacturer of household glassware products. Competing imports are classified under heading 7013 of the Harmonized Tariff Schedules of the United States (HTS) as "[g]lassware of a kind used for table, kitchen, toilet, office, indoor decoration or similar purposes."

Libbey does not oppose Chile's accession to NAFTA. It does, however, ask that accession include the same period for phaseout of U.S. tariffs on HTS 7013 glassware as applied to those imports from Mexico under NAFTA. Those phaseout periods (fifteen years in most instances) are shown on Table 1.

As the Committee and Subcommittee are well aware from prior proceedings, the U.S. glassware industry is highly import and price sensitive. These sensitivities increase with each annual increase in imports, contraction of U.S. producers' share of the U.S. market, and reduced employment. Tables showing import growth rates, loss of domestic market share and loss of employment in the sector are attached as Tables 2, 3 & 4.

Most notably increased is competition from developing countries; having substantially lower labor costs they easily undercut U.S. prices. The interest of developing countries in exporting glassware products to the U.S. market is indicated not only by the surge in imports from those countries but also by the surge in petitions since 1989 asking for GSP designation of glassware products. Highlighting the unique sensitivities of the glassware sector, however, "import-sensitive semimanufactured and manufactured glass products" is one of the few categories of products ineligible for duty-free treatment under the Generalized System of Preferences (GSP). 19 U.S.C. § 2463(c)(1)(F) [section 503(c)(1)(F) of Trade Act of 1974, PL 93-618]. Accordingly, most petitions to add glassware categories to the list of products eligible under the GSP are summarily rejected or denied. See Table 5.

Chile's Accession to NAFTA
Comments of Libbey Inc.
July 13, 1995

TABLE 1

TARIFF REDUCTIONS ON GLASSWARE UNDER THE NAFTA

HTS Item		Pre-NAFTA MFN Rate	Staging Category	
7013.10.1000	GLS-CRMC GLSSWR,KTCHN,NONGLZD,75P CRYSTLLNE,ETC	6.9%	A	Immediate
7013.10.5000	GLSWR OF GLS-CERMCS FOR TBL,KITCHN, OFFC, ETC NSPF	26.0%	C+	15 annual cuts, duty free by 2008
7013.21.1000	LEAD CRYSTAL DRINKING GLASSES VALUD NT OVR $1 EACH	20.0%	C+	15 annual cuts, duty free by 2008
7013.21.2000	LEAD CRYSTAL DRINKING GLASSES VALUED $1-$3 EACH	14.0%	C+	15 annual cuts, duty free by 2008
7013.21.3000	LEAD CRYSTAL DRINKING GLASSES VALUED $3-$5 EACH	10.5%	C+	15 annual cuts, duty free by 2008
7013.21.5000	LEAD CRYSTAL DRINKING GLASSES VALUED OVER $5 EACH	6.0%	A	Immediate
7013.29.0500	DRINKING GLASSES OF SPECIALLY TEMPERED GLASS	12.5%	C+	15 annual cuts, duty free by 2008
7013.29.1000	DRINKING GLASSES NESOI VALUED NOT OVER 30CNTS EACH	38.0%	C+	15 annual cuts, duty free by 2008
7013.29.2000	DRINKING GLASSES NESOI VALUED OV $ 30, NT OV $3	30.0%	C+	15 annual cuts, duty free by 2008
7013.29.3000	DRINKING GLASSES NESOI, CUT OR ENGRVD VALU $3-$5 EA	15.0%	C+	15 annual cuts, duty free by 2008
7013.29.4000	DRINKING GLASSES NESOI CUT OR ENGRAVD VALU OV $5EA	7.2%	B	5 annual cuts, duty free by 1998
7013.29.5000	DRINKING GLASSES NESOI NT CUT/ENGRVD VAL $3-$5 EA	15.0%	C+	15 annual cuts, duty free by 2008
7013.29.6000	DRINKING GLASSES NESOI NT CUT OR ENGR VAL OV $5 EA	7.2%	B	5 annual cuts, duty free by 1998
7013.31.1000	LEAD CRYSTAL WARE FR TABL/KIT NES VALU NOV $1 EACH	20.0%	C+	15 annual cuts, duty free by 2008
7013.31.2000	LEAD CRYSTAL WARE FR TABL/KIT NES VAL $1-$3 EACH	14.0%	C+	15 annual cuts, duty free by 2008
7013.31.3000	LEAD CRYSTAL WARE FR TABLE/KTCH NESOI VAL $3-$5 EA	10.5%	C+	15 annual cuts, duty free by 2008
7013.31.5000	LEAD CRYSTAL WARE FR TABLE/KTCHN NESOI VAL OV $5EA	6.0%	A	Immediate
7013.32.1000	PRESSD/TUFFND GLS W LIN COEF NOV 5X10-6, TABLE NES	12.5%	C+	15 annual cuts, duty free by 2008
7013.32.2000	KITCH GLSWR W LIN COEF NOV 5X10-6 NES NT OV $3 EAC	30.0%	C+	15 annual cuts, duty free by 2008
7013.32.3000	KITCH GLSWR W LIN COEF NOV 5X10-6 NES $3-5 EACH	15.0%	C+	15 annual cuts, duty free by 2008
7013.32.4000	KITCH GLSWR W LIN COEF NOV 5X10-6 NES OV $5 EACH	7.2%	C+	15 annual cuts, duty free by 2008
7013.39.1000	KITCH GLSWR W LIN COEF 5X10-6 OM NES PRESD A TUFFN	12.5%	C+	15 annual cuts, duty free by 2008
7013.39.2000	KITCH GLSWR W LIN COEF 5X10-6 OM NESOI NT OV $3	30.0%	C+	15 annual cuts, duty free by 2008
7013.39.3000	KITCH GLSWR LIN COEF 5X10-6 OM NES CUT/ENGR $3-5	15.0%	C+	15 annual cuts, duty free by 2008
7013.39.4000	KITCH GLSWR LIN COEF 5X10-6 OM NES CUT/ENGR OV $5	7.2%	C+	15 annual cuts, duty free by 2008
7013.39.5000	KITCH GLSWR LIN COEF 5X10-6 OM NES NT CT/ENGR $3-5	15.0%	C+	15 annual cuts, duty free by 2008
7013.39.6000	KITCH GLSWR LIN COEF 5X10-6 OM NES NT CT/ENGR OV$5	7.2%	C+	15 annual cuts, duty free by 2008
7013.91.1000	LEAD CRYSTALWARE FOR TOILET, OFFC ETC NES NT OV $1	20.0%	C+	15 annual cuts, duty free by 2008
7013.91.2000	LEAD CRYSTALWR FOR TOILET, OFFC ETC NES $1-3 EACH	14.0%	C+	15 annual cuts, duty free by 2008
7013.91.3000	LEAD CRYSTALWR FOR TOILET, OFFC ETC NESOI $3-5 EA	10.5%	C+	15 annual cuts, duty free by 2008
7013.91.5000	LEAD CRYSTALWR FOR TOILET, OFFC ETC NESOI OV $5 EA	6.0%	A	Immediate
7013.99.1000	GLASSWR NESOI DECRTD W METAL, BUBBLES, COLORS ETC	20.0%	C+	15 annual cuts, duty free by 2008
7013.99.2000	GLSWR FR TOILT, OFFC ETC NES PRESSED A TOUGHENED	12.5%	C+	15 annual cuts, duty free by 2008
7013.99.3000	GLASS SMOKERS'S ARTCLS, PERFUM BOTLS W GRD GLS STP	9.0%	A	Immediate
7013.99.3500	GLASS VOTIVE-CANDLE HOLDERS	6.5%	A	Immediate
7013.99.4000	GLSWR FR TOILT, OFFC ETC NESOI NT OVR 30 CNTS EACH	38.0%	C+	15 annual cuts, duty free by 2008
7013.99.5000	GLSWR FR TOILT, OFFC ETC NESOI OV $ 30, NT OV $3EA	30.0%	C+	15 annual cuts, duty free by 2008
7013.99.6000	GLSWR FR DECOR ETC NES CUT/ENGRVD $3-5 EACH	15.0%	C+	15 annual cuts, duty free by 2008
7013.99.7000	GLSWR FR DECOR ETC NESOI CUT OR ENGRVD OVER $5 EA	7.2%	C+	15 annual cuts, duty free by 2008
7013.99.8000	GLSWR FR DECOR ETC NES NT CUT/ENGRVD $3-5 EACH	15.0%	C+	15 annual cuts, duty free by 2008
7013.99.9000	GLSWR FOR DECOR ETC NESOI NT CUT/ENGRVD OVER $5 EA	7.2%	C+	15 annual cuts, duty free by 2008

Source: USTR, NAFTA Tariff Schedules

Chile's Accession to NAFTA
Comments of Libbey Inc.
July 13, 1995

TABLE 2

U.S. IMPORTS OF GLASSWARE: 1989-1994

FAS Value in $000s: Ranked on 1994 Value

	1989	1990	1991	1992	1993	1994	% Cng 89-94
NON-GSP COUNTRIES							
FRANCE	$112,821	$120,374	$110,275	$97,883	$101,407	$115,475	2.53%
GERMANY	$68,856	$84,772	$81,500	$82,385	$73,934	$84,076	22.10%
IRELAND	$73,062	$55,109	$51,411	$49,251	$55,675	$64,752	-11.37%
ITALY	$27,586	$32,413	$31,612	$34,619	$32,090	$38,753	40.48%
AUSTRIA	$16,565	$15,780	$16,567	$20,914	$26,356	$35,003	111.31%
CHINA (MAINLAND)	$4,936	$6,725	$8,847	$15,356	$22,924	$34,969	606.47%
JAPAN	$24,976	$23,139	$28,942	$34,337	$37,512	$33,163	32.78%
MEXICO	$21,174	$18,771	$18,672	$21,672	$24,230	$27,504	29.90%
CHINA (TAIWAN)	$27,868	$28,951	$28,776	$32,584	$29,423	$26,639	-4.46%
SWEDEN	$14,337	$13,000	$10,085	$10,288	$12,550	$12,160	-15.18%
SPAIN	$6,071	$5,027	$4,614	$6,316	$6,576	$12,105	99.39%
CANADA	$3,593	$3,626	$3,797	$6,106	$8,938	$11,269	213.64%
UNITED KINGDOM	$8,680	$9,064	$7,209	$8,232	$8,421	$9,699	11.74%
KOREA, REPUBLIC OF	$5,532	$5,098	$8,030	$5,800	$5,834	$4,910	-11.25%
PORTUGAL	$8,649	$7,903	$5,553	$4,384	$4,334	$3,989	-40.00%
SWITZERLAND	$525	$2,599	$1,366	$1,664	$2,822	$3,576	581.21%
NETHERLANDS	$1,575	$1,175	$1,474	$2,607	$2,537	$3,522	123.63%
BELGIUM	$3,544	$5,574	$3,949	$3,357	$2,929	$3,330	-6.04%
HONG KONG	$1,656	$1,550	$1,399	$1,152	$1,774	$1,239	-25.17%
DENMARK	$654	$440	$3,172	$718	$829	$1,034	58.25%
FINLAND	$1,852	$716	$1,119	$1,121	$891	$859	-53.64%
NORWAY	$170	$182	$207	$178	$102	$355	109.66%
AUSTRALIA	$640	$457	$387	$345	$383	$89	-86.13%
ICELAND						$73	
GREECE	$151	$188	$115	$61	$74	$68	-55.09%
LUXEMBOURG	$85	$76	$49	$408	$70	$27	-67.78%
ARMENIA						$14	
VATICAN CITY						$9	
MONACO	$0	$7	$145	$90	$0	$7	
BERMUDA	$0	$0	$0	$4	$8	$3	
SINGAPORE	$21	$8	$20	$11	$15	$3	-86.49%
SYRIAN ARAB REPUBLIC						$3	
LIECHTENSTEIN	$4	$27	$0	$3	$23	$2	-35.60%
NEW ZEALAND	$0	$0	$2	$0	$2	$2	
YUGOSLAVIA	$26,962	$24,942	$25,699	$12,960	$102		
IRAN	$0	$0	$39	$0	$0		
IRAQ	$0	$26	$0	$0	$0		
UNITED ARAB EMIRATES	$16	$0	$0	$0	$0		
FR SO.-ANTARTIC LANDS	$5	$0	$0	$0	$0		
MARTINIQUE	$0	$0	$9	$0	$0		
GERMAN DEM. REP.	$5,016	$3,611	$0	$0	$0		
SAN MARINO	$0	$0	$0	$27	$63		
GUADELOUPE	$1	$0	$0	$4	$0		
FED. ST. MICRONESIA	$0	$0	$0	$10	$0		
NON-GSP COUNTRIES	**$465,402**	**$471,334**	**$455,043**	**$454,849**	**$462,628**	**$528,584**	**13.58%**
Percent of Total:	*91.31%*	*90.89%*	*89.81%*	*86.03%*	*81.76%*	*82.61%*	
GSP COUNTRIES							
LDDC GSP							
HAITI	$59	$35	$442	$311	$226	$216	262.84%
SIERRA LEONE	$0	$0	$0	$6	$459	$118	
BANGLADESH						$1	
MOZAMBIQUE	$2	$0	$2	$0	$0		
RWANDA	$25	$0	$0	$0	$0		
OTHER GSP							
POLAND	$11,457	$15,673	$19,461	$22,389	$27,259	$33,417	191.66%
SLOVENIA	$0	$0	$0	$10,770	$26,633	$23,961	

Source: U.S. Dept of Commerce, Bureau of Census. Excludes data for items classified under HTS 7013.10 - Glass Ceramics.

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	1989	1990	1991	1992	1993	1994	% Cng 89-94
THE CZECH REPUBLIC	$0	$0	$0	$0	$12,622	$12,628	
HUNGARY	$3,708	$3,593	$4,892	$5,290	$6,055	$6,153	65.92%
ROMANIA	$7,086	$5,113	$3,882	$2,035	$1,798	$5,145	-27.39%
INDONESIA	$2,146	$3,261	$4,092	$8,446	$7,320	$5,039	134.84%
TURKEY	$7,706	$6,942	$5,268	$5,313	$5,704	$4,931	-36.01%
THAILAND	$1,915	$2,153	$1,885	$1,964	$2,577	$3,102	62.00%
MALAYSIA	$573	$613	$1,040	$2,588	$2,755	$3,039	430.13%
CROATIA	$0	$0	$0	$1,386	$2,742	$2,491	
SLOVAKIA	$0	$0	$0	$0	$1,971	$2,001	
BRAZIL	$1,817	$1,890	$1,915	$1,238	$1,622	$1,875	3.18%
DOMINICAN REPUBLIC	$0	$2	$13	$230	$809	$1,281	
PHILIPPINES	$0	$5	$8	$85	$236	$832	
EGYPT	$19	$28	$253	$242	$341	$803	4135.19%
BOSNIA-HERCEGOVINA	$0	$0	$0	$0	$17	$670	
INDIA	$61	$81	$75	$117	$287	$600	887.64%
ARGENTINA	$938	$1,372	$575	$241	$138	$463	-50.67%
ISRAEL	$455	$399	$180	$219	$275	$393	-13.68%
COLOMBIA	$335	$217	$198	$149	$292	$382	14.01%
RUSSIA	$746	$678	$306	$403	$398	$352	-52.79%
BELARUS	$0	$0	$0	$0	$159	$291	
GUATEMALA	$62	$22	$5	$30	$20	$248	298.32%
BULGARIA	$117	$216	$28	$14	$53	$181	54.33%
ECUADOR	$6	$0	$50	$0	$10	$127	2173.10%
UKRAINE						$121	
TUNISIA	$0	$1	$0	$1	$0	$110	
VENEZUELA	$60	$274	$158	$121	$99	$108	78.88%
PANAMA	$37	$42	$50	$8	$75	$45	21.66%
URUGUAY	$37	$9	$0	$44	$35	$38	4.34%
PAKISTAN	$16	$0	$7	$0	$0	$33	102.68%
MACAO	$0	$0	$0	$2	$0	$18	
REP. OF SO. AFRICA	$0	$0	$0	$6	$0	$17	
COSTA RICA	$0	$0	$0	$5	$0	$15	
PERU	$34	$58	$14	$10	$10	$12	-63.97%
BURUNDI						$12	
SWAZILAND	$0	$0	$0	$0	$1	$11	
LEBANON	$4	$0	$0	$4	$0	$9	107.91%
BARBADOS						$3	
LITHUANIA						$3	
MOROCCO	$0	$0	$0	$3	$43	$3	
MALTA AND GOZO	$14	$6	$4	$0	$0	$3	-81.43%
SURINAME						$2	
CHILE	$34	$59	$95	$0	$2	$1	-95.76%
FRENCH POLYNESIA						$0	
ARUBA	$0	$0	$0	$13	$0		
BAHAMAS	$8	$1	$0	$18	$0		
CAYMAN ISLANDS	$6	$1	$1	$6	$0		
KYRGYZSTAN	$0	$0	$0	$3	$0		
TRINIDAD AND TOBAGO	$451	$73	$89	$0	$0		
TONGA	$0	$1	$0	$0	$0		
TOKELAU ISLANDS	$0	$0	$0	$0	$29		
SRI LANKA	$0	$4	$0	$0	$0		
SEYCHELLES	$0	$0	$0	$0	$4		
NETHERLANDS ANTILLES	$2	$0	$0	$0	$3		
JAMAICA	$0	$7	$0	$0	$0		
MAURITIUS	$0	$0	$37	$3	$9		
COCOS ISLANDS	$0	$0	$0	$0	$82		
ZAIRE	$0	$4	$0	$0	$0		
JORDAN	$0	$0	$0	$0	$2		
ANTIGUA	$4	$24	$0	$0	$0		
HONDURAS	$0	$0	$3	$0	$0		
GUYANA	$0	$3	$0	$0	$0		
GHANA	$2	$0	$0	$0	$0		
DOMINICA	$22	$0	$43	$15	$11		
CZECHOSLOVAKIA	$4,302	$4,211	$6,534	$10,151	$0		
MONTSERRAT	$0	$0	$0	$0	$6		
GSP COUNTRIES	**$44,267**	**$47,270**	**$61,606**	**$73,881**	**$103,193**	**$111,303**	**151.44%**
Percent of Total:	*8.69%*	*9.11%*	*10.19%*	*13.97%*	*18.24%*	*17.39%*	
Total All Countries:	**$509,669**	**$518,804**	**$606,648**	**$528,730**	**$565,821**	**$639,887**	**25.55%**

Source: U.S. Dept of Commerce, Bureau of Census. Excludes data for items classified under HTS 7013.10 - Glass Ceramics.

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TABLE 3

In Current Dollars

Glassware Classifiable Under HTS 7013 and TSUS 546: Apparent Consumption, Imports, and Imports as a Percentage of Apparent Consumption
(Millions of U.S. Dollars)

	A Domestic Producers' Shipments From MA32E	B Interplant Transfers From MA32E	C Net Domestic Producers' Shipments [A - B]	D Exports	E Imports	U.S. Cons. [C - D + E]	Imports % of Total U.S. Cons.
1976	$730	$55	$675	$64	$94	$705	13.3%
1977	$785	$55	$729	$69	$113	$773	14.6%
1978	$865	$86	$779	$90	$168	$857	19.6%
1979	$912	$106	$806	$89	$210	$927	22.6%
1980	$1,030	$166	$864	$103	$240	$1,001	24.0%
1981	$1,150	$180	$970	$114	$252	$1,108	22.7%
1982	$1,152	$143	$1,009	$83	$282	$1,209	23.4%
1983	$1,183	$272	$912	$63	$339	$1,188	28.5%
1984	$1,307	$361	$946	$65	$463	$1,343	34.5%
1985	$1,215	$415	$800	$49	$472	$1,223	38.6%
1986	$1,278	$465	$813	$48	$537	$1,304	41.2%
1987	$1,264	$453	$811	$59	$550	$1,301	42.3%
1988	$1,362	$575	$787	$67	$581	$1,301	44.7%
1989	$1,360	$548	$811	$86	$622	$1,348	46.2%
1990	$1,397	$606	$791	$123	$627	$1,295	48.4%
1991	$1,452	$659	$792	$137	$601	$1,256	47.8%
1992	$1,575	$718	$858	$151	$635	$1,342	47.3%
1993	$1,600	$694	$906	$168	$672	$1,411	47.7%

Sources:
Domestic shipments, interplant transfers, and exports are from Department of Commerce, 1977-1993 Current Industrial Reports for Consumer, Scientific, Technical, and Industrial Glassware: product codes 32291 (1977) and 32291 and 32317 (1978 and subsequent reports), both covering "Table kitchen, art, and novelty glassware," covering all, and only, merchandise classifiable under the TSUS 546 items and HTS 7013 items (excluding ceramic at HTS 7013.10.10 & 10.50, which is not here at issue and was not part of TSUS 546. Revised data for each year taken from the following year's issue for shipments and interplant transfers (e.g., 1978 issue for 1977 data, etc.). Net domestic producer shipments is Domestic Producer Shipments less interplant transfers. Imports are aggregate landed costs from U.S. Department of Commerce Import Statistics. (1978 -1993)

Note: Data for 1988-93 includes data for Glass Ceramics, HTS 7013.10, which was not included in the precedent TSUS provision (TSUS 546) nor therefor in the data for 1976 -1988.

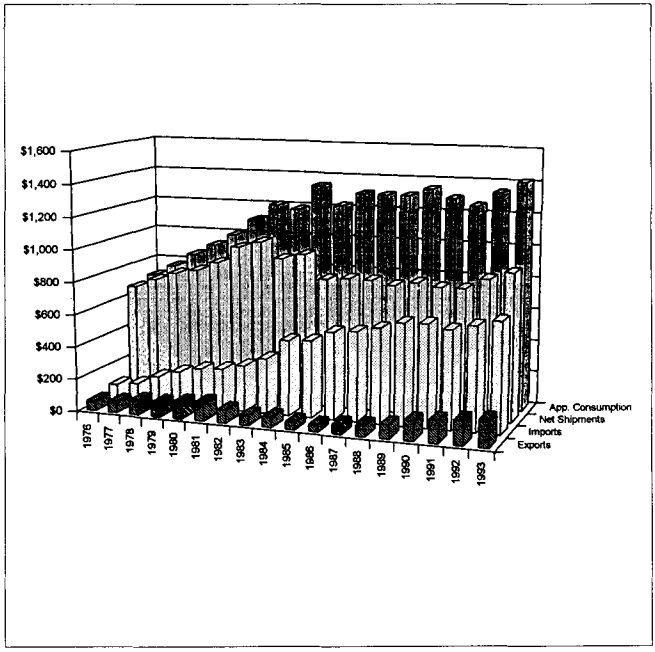

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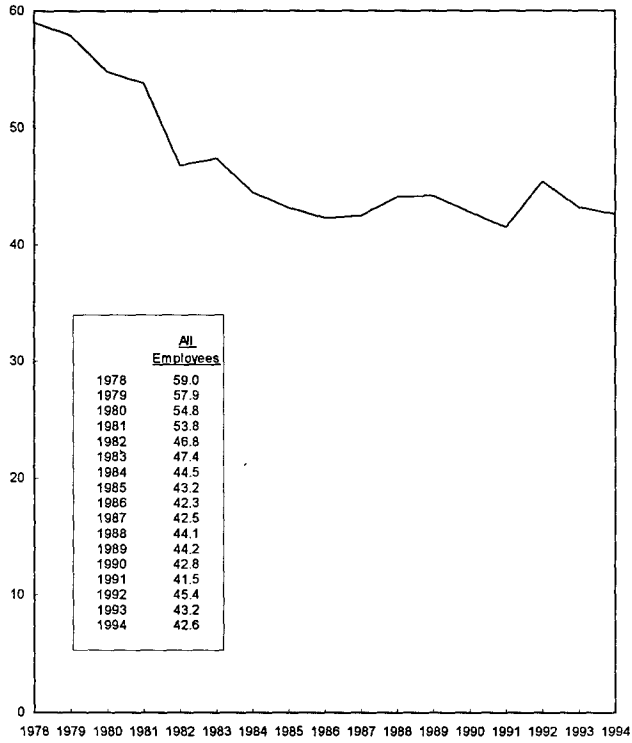
TABLE 4

Employment in the Pressed and Blown Glass Industry
SIC 3229
1978 -1994



	All Employees
1978	59.0
1979	57.9
1980	54.8
1981	53.8
1982	46.8
1983	47.4
1984	44.5
1985	43.2
1986	42.3
1987	42.5
1988	44.1
1989	44.2
1990	42.8
1991	41.5
1992	45.4
1993	43.2
1994	42.6

Source: Employment, Hours, and Earnings, U.S. 1909-1990, Vol. 1; US Dep't of Labor at 20, March 1991 Supplement to Employment and Earnings; at pp 119-121; July 1991; Data for 1992, 1993 from March 93 and 94 EH&E respectively. Data for 1994 compiled from March, June, August, October, December 1994, and February 1995 EH&E.

TABLE 5

GSP PETITIONS ON GLASSWARE CLASSIFIABLE UNDER HTS 7013
1989 - 1992

	1989 ANNUAL REVIEW			SPECIAL ANDEAN REVIEW			1990 ANNUAL REVIEW			SPECIAL CENTRAL & EASTERN EUROPE REVIEW			1992 ANNUAL REVIEW		
	Number of Petitions	Accepted / Rejected for Review	GSP Status Granted / Denied	Number of Petitions	Accepted / Rejected for Review	GSP Status Granted / Denied	Number of Petitions	Accepted / Rejected for Review	GSP Status Granted / Denied	Number of Petitions	Accepted / Rejected for Review	GSP Status Granted / Denied	Number of Petitions	Accepted / Rejected for Review	GSP Status Granted / Denied
7013.21.1000							3	Rejected							
7013.21.2000							5	Rejected		1	Accepted	Denied			
7013.21.3000							5	Rejected		1	Accepted	Denied			
7013.21.5000							5	Accepted	Granted						
7013.29.0500							3	Rejected					1	Rejected	
7013.29.1000	1	Rejected		1	Accepted	Denied	6	Rejected		1	Rejected				
7013.29.2000	1	Rejected		1	Accepted	Denied	6	Rejected		2	Rejected				
7013.29.3000				1	Accepted	Denied	4	Rejected		1	Rejected				
7013.29.4000				1	Accepted	Denied	4	Rejected		1	Rejected				
7013.29.5000				1	Accepted	Denied	8	Rejected		1	Rejected				
7013.29.6000				1	Accepted	Denied	8	Rejected		1	Rejected				
7013.31.1000							3	Rejected							
7013.31.2000							5	Rejected							
7013.31.3000							5	Rejected		1	Accepted	Granted			
7013.31.5000							5	Accepted	Granted						
7013.32.1000	1	Rejected					1	Rejected					1	Rejected	
7013.32.2000							1	Rejected							
7013.32.3000							1	Rejected							
7013.32.4000							1	Rejected							
7013.39.1000				1	Accepted	Denied	1	Rejected		2	Rejected		1	Rejected	
7013.39.2000				1	Accepted	Denied	4	Rejected		2	Rejected				
7013.39.3000				1	Accepted	Denied	2	Rejected		2	Rejected				
7013.39.4000				1	Accepted	Denied	2	Rejected		2	Rejected				
7013.39.5000	1	Rejected		1	Accepted	Denied	4	Rejected		1	Rejected				
7013.39.6000				1	Accepted	Denied	4	Rejected		1	Rejected				
7013.91.1000							1	Rejected							
7013.91.2000							3	Rejected							
7013.91.3000							3	Rejected							
7013.91.5000							3	Accepted	Granted						
7013.99.1000							1	Rejected							
7013.99.2000	1	Rejected		1	Accepted	Denied	3	Rejected							
7013.99.4000	1	Accepted	Denied	1	Accepted	Denied	4	Rejected							
7013.99.5000				1	Accepted	Denied	1	Rejected							
7013.99.6000				1	Accepted	Denied	1	Rejected							
7013.99.7000				1	Accepted	Denied	1	Rejected							
7013.99.8000				1	Accepted	Denied	3	Rejected							
7013.99.9000							3	Rejected							

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Notwithstanding the extended period for phaseout of U.S. tariffs on imports from Mexico, Mexico's glassware exports to the U.S. jumped by 53% in 1994, the first year of NAFTA's implementation.

U.S. IMPORTS OF GLASS & GLASSWARE ARTICLES FROM MEXICO
1990-1994
FAS Value in Dollars; Quantity in No. of Units

	Quantity	FAS Value	Unit Value	Percent Change Quantity	Percent Change FAS Value	
1990	49,740,480	$ 18,771,056	$ 0.38			
1991	49,831,442	$ 18,672,454	$ 0.37	0.18%	-0.53%	*1990-1991*
1992	48,694,997	$ 21,671,925	$ 0.45	-2.28%	16.06%	*1991-1992*
1993	47,243,342	$ 24,230,431	$ 0.51	-5.02%	29.08%	*Cumulative 1990-93*
1994	72,439,901	$ 27,504,215	$ 0.38	**53.33%**	13.51%	*1993-1994*

Source: U.S. Department of Commerce, Bureau of Census, Imports for Consumption for glassware classifiable under HTS 7013, excluding glass ceramics

The relatively-high tariffs on glassware have not been sufficient otherwise to prevent annual increases in imports. Tariffs have been eroded piecemeal, moreover, through the various free trade agreements, through unilateral tariff elimination under the Caribbean Basin Economic Recovery Act and the Andean Trade Preference Act, through the Uruguay Round cuts of the higher, more-import-sensitive glassware tariffs, and through those GSP petitions that have been granted.

The adverse industry trends are expected to continue as tariffs are further liberalized through the phase-in of the NAFTA and as Uruguay Round cuts are phased in.

For the foregoing reasons, Libbey asks that Chile's accession be accompanied by the same phaseout period for U.S. tariffs on HTS 7013 glassware as applied to those imports from Mexico.

Although presently there are few imports of glassware from Chile, statistics of past imports demonstrate that Chile certainly has the ability to produce for exportation to the United States. It could renew and expand that production to take advantage of a preferential tariff position. Moreover, the world's major glassware producers are international entities that can add capacity in Chile relatively easily to take advantage of preferential tariff rates. In light of the industry's high degree of import sensitivity, as well as its price sensitivity, the extended phaseout of U.S. tariffs on imports from Chile is warranted.

Libbey prefers at this time to make clear that its priority is retention of the U.S. tariffs over the maximum period possible. Accordingly, it makes no specific proposal concerning priorities or the time frame over which Chilean glassware tariffs should be eliminated.

Respectfully submitted,

STEWART AND STEWART
Special Counsel for Libbey Inc.

Terence P. Stewart
Charles A. St. Charles

STATEMENT OF MANATT, PHELPS & PHILLIPS BEFORE THE HOUSE WAYS AND MEANS TRADE SUBCOMMITTEE U.S. HOUSE OF REPRESENTATIVES WASHINGTON, D.C.

HEARING ON THE ACCESSION OF CHILE TO THE NAFTA

June 21, 1995

International trade counsel at Manatt, Phelps & Phillips represent a broad spectrum of companies doing business under the NAFTA throughout Mexico and the United States, and we are pleased to submit this statement in strong support of NAFTA's Chapter 19 dispute settlement system, and its extension to trade agreements providing for Chile's accession to the NAFTA.

Introduction

Chapter 19 of the North American Free Trade Agreement ("NAFTA"), like its precursor Chapter 19 of the U.S.-Canada Free Trade Agreement ("USCFTA"), has created a valuable and eminently workable multinational dispute settlement system that has productively resolved a multitude of antidumping ("AD") and countervailing duty ("CVD") appeals since its creation. Under the NAFTA Chapter 19 dispute settlement process, AD and CVD determinations by the governments of the NAFTA countries are appealable to carefully selected panels of individuals appointed for their knowledge of international trade law and their judicial temperaments.

U.S. Trade Ambassador Mickey Kantor recently stated that the U.S. will agree to make only those changes to the NAFTA that are necessary to accommodate Chile's successful accession to the agreement. Similarly, Deputy U.S. Trade Representative Charlene Barshefsky has expressed her strong support for extending the existing NAFTA dispute settlement system to Chile. As Ambassador Barshefsky has described it, "Chile's joining the NAFTA is an accession to the NAFTA, and the NAFTA is the NAFTA," meaning Chile's accession is not an opportunity to rewrite NAFTA's provisions.

Chapter 19 is the product of a lengthy and contemplative debate which resulted in the establishment of a permanent dispute settlement system that has become known for its consistent record of successful dispute resolution. Those who argue that the Chapter 19 dispute settlement system began as merely a "temporary" measure under the USCFTA fail to recognize that its now-permanent status is a direct reflection of its recognized success.

Not unpredictably, parties who have failed to prevail in disputes before the Chapter 19 panels are now among the system's most vocal critics -- and they seek to prohibit the extension of the Chapter 19 dispute settlement system to additional trade agreements. Unfortunately, those who have lost cases before the panels are critical of the system for reasons totally unrelated to the actual workings of the Chapter 19 dispute settlement process. Consequently, their complaints are accurately dismissed as little more than "sour grapes."

The Chapter 19 dispute settlement process is not, as critics have alleged, a confusing "ad hoc" initiative comprised of individuals with uncertain motives or little background in the subject area. Instead, review panels established under Chapter 19, by law, must consist of knowledgeable experts in the trade field and judges or former judges "to the fullest extent practicable." The binational panels established under Chapter 19 must consist of five individuals drawn from a roster established by the three countries. Pursuant to NAFTA Annex 1901.2, candidates to be panelists must be "of good character, high standing and repute, and shall be chosen strictly on the basis of objectivity, reliability, sound judgment and general familiarity with international trade law." Furthermore, a majority of the members of each panel must be lawyers in good standing, and the chair of each panel must be a lawyer elected by the other panelists.

In addition, the Chapter 19 appellate body under the NAFTA, known as the Extraordinary Challenge Committee ("ECC"), must be comprised of three members -- all of whom must be judges or former judges. The preference for judges on the NAFTA Chapter 19 panels and the ECC was added to the NAFTA at the request of the United States precisely to ensure the presence of individuals who would exhibit impartiality, objectivity, the ideal judicial temperament and experience in applying a proper standard of review.

The NAFTA Code of Conduct

The NAFTA Chapter 19 dispute settlement process was implemented based on commitments that panels reviewing U.S. agency determinations would be bound by U.S. law and its governing standard of review, and that there would be strict and fully-enforced conflict-of-interest rules applied to panelists. These commitments have been met in their entirety in the NAFTA Chapter 19 dispute settlement process.

NAFTA Chapter 19 panelists are fully accountable for their actions, and proper safeguards to ensure their impartiality were implemented with the NAFTA. NAFTA Panel Rule 43 makes it clear that not only Chapter 19 panelists and committee members but also their assistants are subject to the NAFTA Code of Conduct, which was established pursuant to NAFTA Article 1909. Members of the NAFTA ECC and their assistants are also subject to the NAFTA Code of Conduct.

The NAFTA Code of Conduct was designed to ensure the integrity and impartiality of Chapter 19 proceedings, and it does so very well. See 59 Fed. Reg. 8720 (February 23, 1994). The main provisions of the Code require that each member of a Chapter 19 panel avoid impropriety and the appearance of impropriety and observe high standards of conduct "so that the integrity and impartiality of the dispute settlement process is preserved." Panelists must avoid entering into relationships or acquiring any financial interest which would affect their impartiality or that would create an "appearance of impropriety or an apprehension of bias." In addition, panelists are prohibited from representing a participant in an administrative proceeding, a domestic court proceeding, or another Chapter 19 panel proceeding involving the same goods.

Specifically in order to avoid conflicts of interest, panelists must disclose, in writing -- both before and after they have read the complaint in a Chapter 19 proceeding -- any interest, relationship or matter that could affect their independence or impartiality, or create an appearance of impropriety or bias. Panelists have a continuing obligation throughout the panel proceeding to disclose interests, relationships and matters "that may bear on the integrity or impartiality of the dispute settlement process."

Strong safeguards to resolve conflicts were included in the NAFTA dispute settlement process. For example, the NAFTA provides that if a party involved in a dispute under Chapter 19 believes that a panelist has violated the NAFTA Chapter 19 Code of Conduct, the parties to the dispute must consult. If, upon consultation, the disputing parties agree that a violation has occurred, the offending panelist must be removed and a new panelist selected. It is clear that safeguards do exist to preserve impartial, objective, and unbiased decisionmaking by panelists and committee members under the NAFTA Chapter 19 dispute settlement process.

In addition, the appellate extraordinary challenge process itself was derived specifically to provide oversight and act as a "check" on Chapter 19 panels. Pursuant to NAFTA Article 1904(13), the ECC may review the actions of panels for conflict of interest on the part of panelists, for failure to follow appropriate procedures, or for exceeding their authority by failing to apply the correct standard of review. The NAFTA sought to reduce the degree to which the ECC could be influenced by politics by requiring that all ECC members be judges or former judges.

Congress, in instituting the Chapter 19 dispute settlement system, sought to be consistent with constitutional due process protections. As a result, the Chapter 19 process preserves the essential requirements of notice and fairness in conformity with proper constitutional standards, and the standards of review employed by the panels reflect those applied in U.S. law. For

example, all parties who otherwise would have standing to appear in a domestic judicial review proceeding also have the right to appear and be represented by counsel before the NAFTA panel under Article 1904(13). In addition, binational panels must adhere to the standard of review prescribed by the NAFTA, which specifically states at Article 1904(3) that "the panel shall apply the standard set out in Annex 1911 and the general legal principles that a court of the importing Party otherwise would apply to a review of a determination of the competent investigating authority," meaning the general legal principles applied by the U.S. Court of International Trade (CIT).

Despite attacks on the constitutionality of the Chapter 19 dispute settlement process, previous challenges to the constitutionality of binational review have been dismissed. See, e.g., National Council for Industrial Defense v. United States, 827 F. Supp. 794 (D.D.C. 1993).

Further, although some have alleged the NAFTA panel process could encourage frivolous challenges, this is a false allegation. The legislative history of the law makes it clear that procedural safeguards were included in the NAFTA panel process specifically to prevent frivolous or unwarranted challenges to the panel review system. In particular, the law provides procedures regulating the bringing of challenges and includes specific provisions for awarding to a party fees and costs incurred in prevailing against a constitutional challenge.

A handful of critics has alleged that the NAFTA dispute settlement system is not needed and need not be extended to additional trade agreements, because the WTO also provides for dispute settlement. The two processes, however, are not synonymous, and the WTO process cannot be a substitute for the Chapter 19 process. The NAFTA panel process has it own specific procedural and substantive requirements and safeguards, as described above. The WTO addresses issues arising under the GATT/WTO; the NAFTA dispute settlement system essentially replaces judicial review of agency application of domestic law. In addition, the NAFTA dispute settlement process applies uniquely to those nations that accede to the NAFTA. Their goals, special needs and their unique trading relationships require that the Chapter 19 dispute settlement system be preserved for them, without foreclosing their opportunity to take issues falling under the GATT/WTO before that body. A multiplicity of optional fora for proper dispute resolution is not necessarily duplicative, and it is not disadvantageous for the U.S. or its trading partners to have recourse to several avenues of dispute resolution.

The NAFTA dispute settlement process (and its predecessor under the CFTA) have worked extremely well and been valuable mechanisms by which many U.S. and foreign interests have sought binding dispute resolution. For this reason and those described above, the Chapter 19 dispute resolution process should be extended to additional nations acceding to the NAFTA, including Chile.

To this end, Congress should direct the Administration to negotiate the inclusion of the NAFTA Chapter 19 dispute settlement system in any upcoming trade agreements concerning accession to the NAFTA. It is especially important that the Chapter 19 dispute settlement system be extended to the proposed trade agreement permitting Chile to accede to the NAFTA, because what is done with Chile -- the first nation to accede to the NAFTA -- will set a precedent for additional nations which accede to the agreement thereafter. It is therefore especially important that the Chapter 19 system be extended at this time, so that it may serve as a model for future trade agreements.

Conclusion

U.S. trade officials responsible for negotiating the accession of additional nations to the NAFTA have explicitly stated that Chile's accession represents a desire on the part of the United States to use NAFTA standards as the basis on which hemispheric integration should proceed. This view is mirrored by trade officials of our trading partners, who have also pledged strong support for the extension of the Chapter 19 dispute settlement system to trade agreements permitting the accession of Chile and other nations to the NAFTA. For these reasons, we strongly support the Chapter 19 dispute settlement process and its extension under the NAFTA.

**SUPPLEMENTAL SHEET ACCOMPANYING
WRITTEN STATEMENT BEFORE THE
HOUSE WAYS AND MEANS TRADE SUBCOMMITTEE
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C.**

**HEARING ON
THE ACCESSION OF CHILE TO THE NAFTA**

June 21, 1995

STATEMENT IN SUPPORT OF EXTENDING THE NAFTA
CHAPTER 19 DISPUTE SETTLEMENT PROCESS TO TRADE
AGREEMENTS PROVIDING
FOR THE ACCESSION OF CHILE TO THE NAFTA

- The accession of countries to the NAFTA is not an opportunity to rewrite its provisions or eliminate the Chapter 19 dispute settlement process. The NAFTA dispute settlement process has evolved into a permanent and valuable mechanism by which to resolve fairly disputes among parties to the NAFTA.

- The Chapter 19 dispute settlement process is not an "ad hoc" initiative; its panels consist of carefully selected individuals, who are chosen on the basis of their objectivity, their good character and their knowledge of trade matters.

- Panelists involved in the Chapter 19 dispute settlement process are fully accountable for their actions, and proper safeguards have been included in the process to ensure their impartiality. Panelists are accountable and subject to the NAFTA Code of Conduct.

- The Chapter 19 dispute settlement process was derived to be consistent with constitutional due process protections, including the essential requirements of notice and fairness. In addition, the standard of review prescribed by the NAFTA reflects the general legal principles that a court of the importing country would otherwise apply to a similar review.

- The NAFTA dispute settlement process has worked extremely well and has been an extremely valuable forum by which many U.S. and foreign companies and their employees have sought successful binding dispute resolution. For all of these reasons, the Chapter 19 dispute settlement process should be extended to any trade agreement permitting the accession of Chile to the NAFTA.

Submitted by and on behalf of:

Irwin P. Altschuler, Esq.
International Trade Counsel
Manatt, Phelps & Phillips
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HOUSE WAYS & MEANS COMMITTEE

STATEMENT OF MATTEL, INC., REGARDING CHILE'S PROSPECTIVE ENTRY INTO THE NORTH AMERICAN FREE TRADE AGREEMENT

July 13, 1995

This statement is submitted on behalf of Mattel, Inc. in response to the House Ways & Means Committee's request for comment regarding the proposed accession of Chile to the North American Free Trade Agreement (NAFTA). Mattel wishes to express its strong support for Chile's inclusion in the NAFTA. Mattel believes Chile's NAFTA accession to be important in its own right, and also as a precedent to be followed by other Latin American countries.

Mattel is the world's largest toy company, with 1994 sales of $3.4 billion in over 140 countries. Headquartered in El Segundo, California, Mattel maintains manufacturing facilities in China, Malaysia, Indonesia, Mexico, Italy, the United Kingdom, as well as in the United States. The company employs 6,430 U.S. workers and nearly 22,000 employees in its facilities around the globe.

Mattel has subsidiaries conducting marketing and other services in 35 countries, which in Latin America include Chile as well as Mexico, Argentina, Brazil and Venezuela. Mattel Chile, a wholly-owned Mattel subsidiary based in Santiago, manages the company's sales and distribution operations throughout Chile.

Chile is an important market for Mattel toys, accounting for over $10 million in sales in 1994. This represented over one quarter of Mattel's toy sales in all of Latin America for the year, even though only one of every 13 children in Latin America lives in Chile.

Over the longer term, however, Mattel sees equally promising markets for toys in other Latin American countries and, for that reason, is supportive of the Administration's long-range vision for the Free Trade Area of the Americas (FTAA) as well as the near-term goal of Chile's accession to the NAFTA. According to UNICEF, there were 114 million children living in Latin America and the Caribbean in 1993, nearly triple the 40 million children living in the United States.

Actions Requested

Mattel requests the immediate elimination of Chile's 11 percent *ad valorem* rates of duty on all toys and related categories as identified in the following section. The immediate elimination of these duties is required for reasons of reciprocity since, effective January 1, 1995, the United States completely eliminated its most-favored-nation (MFN) duties on all toys. This was done as

part of the zero-for-zero deal on toys struck as part of the Uruguay Round of multilateral trade negotiations.

Except for Korea, however, no developing countries participated in the zero-for-zero arrangement on toys. As a result, it is critical that the United States redress this imbalance by insisting, *inter alia*, that all new members of the NAFTA, or other free trade agreements to which the United States is a party, commit to the immediate elimination of their tariffs on toys and in other zero-tariff sectors.

In addition, Mattel requests that Congress urge U.S. negotiators to ensure that Chile's NAFTA accession protocol precludes the country from raising any non-tariff barriers to imports of toys and toy-related products, although no such barriers are known to exist today. In particular, Mattel urges that the accession protocol be tightened to ensure that the Chilean government does not establish new standards or certification requirements on toys that could serve as significant non-tariff barriers to the Chilean market.

Mattel views these standards/certification concerns as more than hypothetical given the company's experiences in Mexico. Following the implementation of the NAFTA agreement, the Mexican government announced that it would require certain toys to be tested and certified by government-approved laboratories before importation. Such certifications are not required in the United States or most other countries and do not advance the cause of consumer safety. Mexico's new certification requirements, which have not yet taken effect, are made worse by the fact that the only laboratories approved by the Mexican government are located in Mexico.

HTS Subheadings of Interest

Mattel supports the immediate elimination of Chile's duties on all toys and toy-related products. These articles are classified primarily under chapter 95 of the Harmonized System (HS), but also under certain headings elsewhere as shown below:

Traditional toy categories:

9501.-- (all)	Wheeled toys
9502.-- (all)	Dolls
9503.-- (all)	Other toys
9504.40	Playing cards
9504.90	Games
9505.90	Festive, carnival or entertainment articles
9506.-- (all)	Sports and exercise equipment

Other toy-related categories of interest:

4202.22	Plastic handbags
4202.92	Other travel or sports bags
8513.10	Flashlights
8519.91	Cassette players
8520.31	Cassette recorders
8543.80	Other machines and apparatus
9608.20	Felt-tipped pens and markers
9608.99	Other pens and pen parts
9610.00	Slates and boards for writing or drawing

Conclusion

Mattel requests that Congress urge the Administration to seek the immediate elimination of Chile's tariffs on the toys and toy-related products of concern. This action will promote the competitiveness of Mattel in the Chilean market by reducing the costs of our NAFTA-originating toys manufactured in Mexico and in the United States. It is also hoped that a commitment by Chile to eliminate its tariffs on toys immediately upon the country's accession to the NAFTA will serve as an important precedent to be followed by subsequent accession candidates.

Respectfully submitted,

Thomas F. St.Maxens
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202/833-4466

On behalf of --

Mattel, Inc.

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July 13, 1995

Philip D. Moseley
Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Moseley:

Re: Chile's Accession to the North American Free Trade Agreement -- Written Comments of Novus International, Inc.

These comments are filed on behalf of Novus International, Inc. in connection with the hearing of the Ways and Means Committee, International Trade Subcommittee, on Chile's accession to the NAFTA, held June 21, 1995.

Novus asks that, in negotiating Chile's accession to the NAFTA, the United States secure immediate elimination of Chile's tariffs on the two products Novus exports from the United States to Chile: (1) D,L-hydroxy analog of D,L-methionine and (2) Ethoxyquin. Novus is a manufacturer of D,L-hydoxy analog of D,L-methionine, and the exclusive distributor of ethoxyquin manufactured by Monsanto Company.

D,L-HYDROXY ANALOG OF D,L-METHIONINE

D,L-hydroxy analog of D,L-methionine (2-hydroxy-4-(methylthio) butanoic acid) is a source of L-methionine, an amino acid essential in the nutrition of microorganisms, plants and animals. L-methionine is utilized inside cells to construct new protein. The "D" and "L" in "D,L-hydroxy analog of D,L-methionine" mean dextro and levo, Latin terms for left and right, referring to the geometric configuration of the molecule. Once ingested, animals metabolize D,L-hydroxy analog of D,L-methionine to reorient the D-oriented molecules into L-oriented molecules and to convert the hydroxy-analog group in the molecule into an amino group. Thus, the molecule becomes L-methionine within the animal.

Novus markets D,L-hydroxy analog of D,L-methionine as an animal feed additive in liquid form and as a calcium salt. The chemical name for the substance in liquid form is "2-hydroxy-4-(methio)butanoic acid", and the chemical name for its calcium salt is "2-hydroxy-4-(methio) butanoic acid calcium salt." The registered trade names of Novus' product are "Alimet" (liquid form) and "MHA" (calcium salt).

D,L-Methionine is classified under item 2930.90.70 of the Harmonized Tariff Schedule of the United States, under item 2930.90.0021 & 29 of the Schedule of Canada, under item 2930.90.54 of the Schedule of Mexico and under item 2930.90 of the Schedule of Chile.

NAFTA Country Tariffs on D,L-Methionine Imports from Chile

	MFN Tariff Rates			
	Bound Rates			Applied Rate
	Pre-Uruguay Round	Post Uruguay Round	Implementation	1995
Canada.....	12.5%	6.5%	2004	11.9%
United States....	3.7%	Free	Immediate	Free
Mexico.....	50.0%	35.0%	n.a.	Free

Chile's Accession to NAFTA
Comments of Novus International, Inc.
July 13, 1995

NAFTA Country NAFTA Tariffs	
Country	Tariff Rate
United States	Free
Canada	Free
Mexico	Free

Chilean Tariffs on Imports of D,L-Methionine from NAFTA Countries	
Imports from	Tariff Rate
United States	11.0% plus 18% VAT
Canada	11.0% plus 18% VAT
Mexico	2.5% to be phased out in 1996 under Chile-Mexico Economic Cooperation Agreement

ETHOXYQUIN

Ethoxyquin (1,2-dihydro-6-ethoxy-2,2,4-trimethylquinoline) is an anti-oxidant agent that scavenges oxygen and other chemical free-radicals. In susceptible feed ingredients, particularly fatty compounds, free radicals, if unchecked, cause free rancidity and significant loss of nutrient quality and, in some instances, spontaneous heating and ignition. Hence, the addition of ethoxyquin to such ingredients:

- prevents oxidative rancidity so the energy value in fats and animal protein meals is maintained and rancid odors do not develop;
- protects vitamins A and E and xanthophyll (a pigment precursor) from destruction during feed mixing and storage;
- prevents oxidative loss of fat-soluble vitamins and pigments even through the digestive process; and
- improves fishmeal quality by suppression of self-heating and ignition.

The chemical name for ethoxyquin is 1,2-dihydro-6-ethoxy-2, 2,4-trimethylquinoline. Novus sells it in the United States and abroad under the registered trade name "Santoquin." The Chilean market uses ethoxyquin as an additive to stabilize and preserve fishmeal, a primary ingredient in feedstuffs for animals and fertilizers. Stabilization is necessary to check fishmeal's spontaneous heating and combustion properties. U.S. Coast Guard regulations, for instance, describe certain fishmeal or scrap products as hazardous cargo because of those properties, which must be checked by addition of ethoxyquin prior to transport on cargo vessels or barges. 49 C.F.R. 148.01-7, 148.04-9. Thus, fishmeal shipped to the United States from Chile would, under U.S. law, have to be treated with ethoxyquin. In light of the spontaneous and combustion properties of fishmeal, such treatment would be necessary for exports from Chile to other countries as well, even if not required by law.

Ethoxyquin is classified under item 2933.40.10 of the Harmonized Tariff Schedule of the United States, under item 2933.40.00 of the Schedule of Canada, under item 2933.40.05 of the Schedule of Mexico and under item 2933.40.90 of the Schedule of Chile.

NAFTA Country Tariffs on Ethoxyquin Imports from Chile				
	MFN Tariff Rates			
	Bound Rates			Applied Rate
	Pre-Uruguay Round	Post Uruguay Round	Implementation	1995
Canada	12.5%	6.5%	2004	11.9%
United States	10.0%	6.5%	Immediate	9.3%
Mexico	50.0%	35.0%	n.a.	15.0%

Chile's Accession to NAFTA
Comments of Novus International, Inc.
July 13, 1995

NAFTA Country NAFTA Tariffs	
Country	Tariff Rate
United States	Free
Canada	6.4% in 1995 on imports from Mexico; *second of ten annual cuts from 8.0%.* Free on imports from the U.S.
Mexico	12.0% in 1995; *second of ten annual cuts from 15%*

Chilean Tariffs on Imports of Ethoxyquin from NAFTA Countries	
Imports from	Tariff Rate
United States	11.0% plus 18% VAT
Canada	11.0% plus 18% VAT
Mexico	2.5% to be phased out in 1996 under Chile-Mexico Economic Cooperation Agreement

REQUESTS

Chile is an important export market for both D,L-hydroxy analog of D,L-methionine and ethoxyquin. Prices for the products in Chile have been depressed, however, as other distributors have increased sales of the same or competing substances and dropped prices. Novus' ability to compete will be enhanced in the Chilean market when Chile's eleven percent tariff is eliminated. As shown on the table herein summarizing tariff rates on the two products, the Chilean tariff on imports of the two substances will be eliminated effective 1996. Novus asks that the United States insist that it receive the same treatment accorded Mexico (i.e., a tariff rate of zero) upon Chile's accession. In that regard, it is important to note that Chile does not produce either substance.

CONCLUSION

In sum, immediate elimination of Chile's tariffs at the effective date of Chile's accession to NAFTA will be beneficial to Novus and Monsanto and their workers, will cause parity between the Chilean rate applied to imports from the United States and the rate that already will be applied to those imports from Mexico effective 1996 (a rate of zero percent). As Chile has no production of the substances, the Chilean government would not be expected to oppose immediate elimination of the tariff.

Respectfully submitted,

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Special Counsel to
NOVUS International, Inc.

PPG Industries, Inc.
One PPG Place Pittsburgh, Pennsylvania 15272 USA Telephone (412) 434-2788

John C. Reichenbach, Jr.
Director
Government Affairs
7 North West

June 19, 1995

Mr. Phillip D. Moseley, Chief of Staff
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: **Written Statement of PPG Industries, Inc. Pursuant to the Subcommittee on Trade June 21, 1995 Hearing on Accession of Chile to the North American Free Trade Agreement**

PPG Industries is pleased to offer several comments on the prospect of Chile's accession to the NAFTA. There are three matters of significant concern to us as the negotiations begin.

First, we believe the United States should insist on tariff parity with Chile, whether at zero/zero or otherwise. It is our understanding that for all or virtually all of the products of interest to PPG, the Chilean tariff is 11% ad valorem, whereas U.S. duties on most commodities average much less. Generally, we support a zero/zero approach with Chile across the board, with equal phase-out periods for both countries, but if that is not possible then tariff parity over the same period of time should be the minimum objective. This position builds upon the fundamental accomplishments of the original NAFTA negotiations, which were intended to be taken as a basis for further improvements in subsequent trade agreements.

Second, in acceding to the NAFTA, Chile must be required to sign the appropriate subsidies and anti-dumping codes as a precursor to membership. Care should also be taken to provide for expedited remediation in the event of sudden, major import surges which impact the United States marketplace.

Finally, the United States must maintain, in the course of Chile's accession, the rules of origin contained in the existing NAFTA agreement. This is viewed as a critical element of the negotiations, and a potential "deal-breaker" if not accomplished. Failure to retain the current NAFTA language regarding rules of origin would undoubtedly result in a major dilution of support for the Agreement.

We appreciate the opportunity to comment on this issue, and will be pleased to respond to any questions or information needs the Subcommittee might have.

Respectfully submitted,

J. C. Reichenbach, Jr.

STATEMENT OF RUBBER AND PLASTIC FOOTWEAR MANUFACTURERS ASSOCIATION

The Rubber and Plastic Footwear Manufacturers Association (RPFMA) is the spokesman for manufacturers of most of the waterproof footwear, rubber soled fabric-upper footwear and slippers produced in this country. The names and addresses of the Association's members appear on Appendix I.

The domestic rubber footwear industry is concerned about the advisability of further free trade agreements in this hemisphere or elsewhere until there is a better opportunity to assess the impact of NAFTA and the effect of the agreements reached in the Uruguay Round. In expressing this concern, it should be noted that this industry supported the outcome of the Uruguay Round, inasmuch as that multilateral market access agreement provided that there would be no tariff cuts on the most import-sensitive products of this industry. Unfortunately, the rules of engagement in bilateral free trade negotiations do not allow for such exceptions.

The rubber footwear industry is labor-intensive, import-sensitive and high-duty. In 1984, imports of fabric-upper, rubber-soled footwear took approximately 86% of our domestic market, and imports of protective footwear took approximately 41%. Labor costs in this industry constitute in excess of 40% of total costs. Duties range from 20% to approximately 65%.

Despite the relatively high duties on rubber footwear, there were no tariff cuts in the Kennedy Round of multilateral trade negotiations, there were virtually no cuts in the Tokyo Round and, as we have pointed out above, there were no cuts in the Uruguay Round on those rubber footwear items essential to the industry's survival.

All rubber footwear items have been exempted from duty-free treatment under the GSP program.

The free trade agreements with both Canada and Israel provided this industry the maximum ten year phaseout for its tariffs.

In the recently concluded NAFTA negotiations, virtually all of the products of this industry were granted a fifteen year phaseout. It is our understanding that such treatment was accorded to less than one half of 1% of all industrial products of this country.

As for Chile, that country has a significant footwear industry whose 1994 production approximated 29 million pair. According to the best information we have been able to obtain, roughly 42% of that production was rubber and canvas footwear. And while Chile's 1994 footwear exports to the United States totaled only 430,000 pair, a phasing out of the United States industry's tariffs would provide an enormous incentive for a dramatic escalation of Chile's exports to this country. Such an escalation is what occurred when the 1990 CBI legislation eliminated duties on footwear exported from the Caribbean to the United States; exports of fabric-upper, rubber soled footwear from that area skyrocketed from 200,000 pair in 1990 to 9,000,000 pair in 1994.

We have been advised that the average monthly earnings of Chilean footwear production workers is about $300. This is no more than 25% of the average earned by American rubber footwear workers. Because of the existing capacity in Chile and the relative ease of increasing that capacity, the retention of our existing duty structure is all that prevents Chile from becoming a much more significant competitor in our marketplace.

It is true that any elimination of duties and non-tariff barriers by Chile may be of value to the export potential of some United States manufacturers, but any such value pales into insignificance when compared to the threat to the continued survival of many manufacturers posed by a free trade agreement

with one more country whose wage standards are so far below our own.

We have urged a re-examination of the rules governing free trade agreements, so that an exception from tariff phaseouts can be made for such import-sensitive industries as rubber footwear. If such a change is not to take place, we urge that authority for negotiations with Chile be conditioned on a requirement that tariff phaseouts for truly import-sensitive industries should cover at least as long a time period as the fifteen years accorded in NAFTA.

APPENDIX I

RUBBER AND PLASTIC FOOTWEAR MANUFACTURERS ASSOCIATION
(June, 1995)

American Steel Toe Co.
P.O. Box 959
S. Lynnfield, MA 01940-0959

Converse, Inc.
One Fordham Road
North Reading, MA 01864

Draper Knitting Co., Inc.
28 Draper Lane
Canton, MA 02134

Frank C. Meyer Co.
585 South Union Street
Lawrence, MA 01843

Genfoot, Inc.
554 Montee De Liesse
Montreal, Quebec PQH4 T1P1
Canada

Gitto Global Corp.
140 Leominster-Shirley Road
Gianna Park, P.O. Box 318
Lunenburg, MA 01462

Hudson Machinery Worldwide
Hudson Industrial Park
P.O. Box 831
Haverhill, MA 02649

Kaufman Footwear Corp.
P.O. Box 9005
410 King Street West
Kitchener, Ontario N2G 4J8
Canada

Kaumagraph, Inc.
P.O. Box 632
525 W. South Street
Kennett Square, PA 19348

LaCrosse Footwear, Inc.
P.O. Box 1328
LaCrosse, WI 54602-1328

New Balance Athletic Shoe, Inc.
38 Everett Street
Allston, MA 02134

Norcross Footwear, Inc.
9300 Shelbyville Rd.
Suite 300
Louisville, KY 40222

S. Goldberg & Co.
20 East Broadway
Hackensack, NJ 07601-6892

Spartech Franklin
113 Passaic Avenue
Kearney, NJ 07032

Tingley Rubber Corporation
P.O. Box 100
S. Plainfield, NJ 07080

BEFORE THE
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE

HEARING ON ACCESSION OF CHILE TO THE NORTH AMERICAN FREE TRADE AGREEMENT

WRITTEN COMMENTS OF
TILE COUNCIL OF AMERICA, INC.

Tile Council of America, Inc. ("Tile Council"), a trade association whose twenty-one regular member companies, identified in Exhibit 1, manufacture over 70% of the ceramic tile produced in the United States, submits these written comments in connection with the Trade Subcommittee's hearings on the negotiation of Chilean accession to the North American Free Trade Agreement ("NAFTA"). Ceramic tile is classified under HTS 6907 (unglazed ceramic tile) and 6908 (glazed ceramic tile).

I. SUMMARY

Tile Council is not opposed to the accession of Chile to NAFTA provided that: (1) ceramic tile from Chile is not provided tariff treatment more favorable than the 15 year "C+" staging already established for ceramic tile from Mexico; (2) the current rule of origin in NAFTA applies to ceramic tile from Chile; (3) effective steps are taken, before any tariff concession is made, to ensure that the rights, health and safety of Chilean workers are subject to protections equivalent to those now in force in the United States and Canada; and (4) effective steps are taken, before any tariff concession is made, to ensure that Chilean manufacturers are subject to environmental protection rules substantially equivalent to those now in force in the United States and Canada.

II. OVERVIEW OF THE AMERICAN CERAMIC TILE INDUSTRY

The American ceramic tile industry consists of about fifty manufacturers and a large number of small "handicraft" tile makers, located throughout the United States. *See* Exhibit 1. The industry employs approximately 10,000 workers.[1]

A. Imports Dominate The American Market

Import penetration -- the ratio of foreign-made tile to American-made tile sold in the United States -- now exceeds 54 percent. Current market penetration is approximately double the 26% market share held by imported tile in 1975. Part of the reason for this rapid and substantial rise in the domination of our market is that the domestic industry has been injured by predatory trade practices. Another factor which has boosted import penetration is the fact that, even at current tariff levels, American manufacturers are forced to operate at a higher cost because many of their foreign competitors do not comply with the environmental, occupational health and safety, and worker rights standards which apply in the United States. At current tariff levels, foreign manufacturers sharply undercut the prices for American-made ceramic tile.

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[1] USITC Report, Inv. Nos. TA-503(a)-20 and 332-90, Pub. 2289 (June 1990) at Digest No. 6907.90.

B. A History of Trade Depredation

Unfair practices by foreign governments and producers have sharply undermined the American ceramic tile industry over the past 20-30 years.

- In Mexico, a combination of improper tax subsidies and subsidized government loans led to the application of countervailing duties on ceramic tile imported from that country. Mexico, which was once the largest U.S. market for tile exports, also imposed an embargo on U.S. ceramic tile during much of the 1980s.

- Widespread dumping and falsification of U.S. customs invoices by Japanese exporters gave Japan a virtual monopoly on the U.S. market for glazed ceramic mosaic tile until the Government of Japan, faced with imminent escape clause action by the U.S. government, took remedial measures.

- British manufacturers conducted a campaign of dumping ceramic tile in the American market. The Commission condemned these practices and imposed dumping duties.

- The Government of the Philippines and its ceramic tile industry instituted a program of dumping and illegal subsidization.

- The European Community also undercut the domestic market by imposing a GSP tariff-rate quota on tile from Thailand. This slashed Thai sales to Germany and other EC countries and led to a commensurate increase of Thai exports of ceramic tile to the United States.

Today, severe import restrictions imposed by numerous countries (including Argentina, Brazil, Ecuador, Indonesia, Malaysia, The Philippines, Sri Lanka, Thailand, Uruguay and Venezuela) effectively bar U.S. exports and divert third-country ceramic tile exports to the United States.

C. U.S. Recognition of Import Sensitivity

Prior Administrations and Congressional leaders have repeatedly recognized the import sensitivity of the American ceramic tile industry.

- Ceramic tile was explicitly recognized as import sensitive in NAFTA and was one of the few industries provided with 15-year "C+" tariff staging.

- Since 1976, the USTR has repeatedly and consistently rejected petitions from some two dozen foreign governments or manufacturers seeking duty-free status for ceramic tile imports under the GSP program. USTR's recognition that the ceramic tile industry is import sensitive led to the rejection of requests by

seven countries, including Mexico, for GSP treatment of ceramic tile in 1990. In 1986, such a finding was made explicit by former GSP Subcommittee Chairman David P. Shark, who explained that USTR had rejected an Argentine request for duty-free treatment because of "the continuing import sensitivity of the domestic ceramic tile industry."

- The Economic Development Administration recognized that the U.S. ceramic tile industry is import sensitive when it awarded an "import-impacted industries" grant to Tile Council.

- Because the domestic ceramic tile industry is import sensitive, ceramic tile was excepted from "formula" tariff reductions in both the Kennedy Round and the Tokyo Round of GATT negotiations.

- In 1961, the Tariff Commission found that the domestic tile industry was the victim of unfair trade practices.

Congressional leaders also have repeatedly recognized the import-sensitivity of the American ceramic tile industry.

- In 1991, 26 Senators and Representatives contacted Ambassador Hills to reaffirm their 1990 opposition to reductions in current U.S. tariffs on ceramic tile.

- In 1990, 63 Senators and Congressmen urged Ambassador Carla Hills to reject requests for duty-free treatment of ceramic tile under the GSP program and/or requests to reduce current U.S. tariffs in the Uruguay Round of GATT negotiations.

- In 1986 seventeen Senators and Congressmen urged Ambassador Clayton Yeutter to remove specialty mosaic tile (now classified as HTS 6908.10.20) from GSP eligibility.

- In 1978, Senators Bentsen, Chiles, Eastland, Ford, Glenn, Helms, Huddleston, Morgan, and Tower and Congressman Neal urged Ambassador Robert S. Strauss to recognize the import-sensitivity of ceramic tile in the Tokyo Round.

- When the Senate Committee on Finance drafted the Trade Act of 1974, ceramic tile was discussed as a clear example of an import-sensitive product which was to be excepted both from the GSP program and the Tokyo Round. Senator Talmadge emphasized this point to former Commission Chairman Catherine Bedell in a 1975 letter.

III. U.S.-CHILE TRADE IN CERAMIC TILE

Chile, though not currently a major exporter of ceramic tile to the United States, has not had any problem accessing the U.S. ceramic tile market. In the past decade imports of ceramic tile from Chile have increased by over 1,000%, from 99,000 square feet in 1985 to 1.1 million square feet in 1994. It is clear that market access is not a problem for Chilean ceramic tile exporters at current U.S. tariff levels. Even with 15 year staging under NAFTA, Chile's exports are almost certain to jump again, just as Mexico's exports of ceramic tile surged 15 percent in 1994, the first year of NAFTA tariff reductions.

Additionally, once Chile is granted NAFTA tariff preferences, it will be relatively easy for Chile to quickly add massive production capacity. State-of-the-art

ceramic tile kilns of great capacity are readily available on the market, with equipment imported primarily from Italy. These large capacity plants would have minimum capacities of 2,500 square meters per day. Smaller plants also are easy to construct and could come into operation very quickly.

Much of the ceramic tile imported from Chile is entered under HTS classification 6908.90, glazed non-mosaic tile. However, due to the ease of supply-side and demand-side substitution all HTS classifications of ceramic tile are competitive and largely interchangeable in the marketplace. Production facilities are readily converted from one size and type of tile to another. Tile in every HTS classification is used as a floor and wall covering. Additional applications, such as kitchen counters, are increasingly popular for all types of ceramic tile.

For these reasons, tariffs for all types of ceramic tile from Chile, as well as ceramic tile from Mexico, should be staged down over a minimum 15 year period.

IV. SPECIFIC OBJECTIVES

Tile Council submits that before U.S. tariffs are reduced, any free trade agreement with Chile must achieve the following specific goals.

A. Stage In Any Tariff Reductions Gradually

The import-sensitive nature of the U.S. ceramic tile industry requires NAFTA tariff reductions to be staged in very gradually. Tile Council submits that the *minimum* staging period for tariffs on ceramic tile from Chile should be 15 years, the period already established for ceramic tile from Mexico.

B. Maintain NAFTA Rules of Origin

Any free trade agreement with Chile must include a rule of origin that will ensure that only ceramic tile fabricated in Chile is eligible for preferential tariff treatment. Tile Council submits that the same rule of origin for ceramic tile included in NAFTA should apply to Chile. The current rule requires that, in order to qualify for national treatment, ceramic tile must be transformed in Chile from one two-digit HTS classification to another. In pragmatic terms, the country of origin is deemed to be the country where the tile body is manufactured. Such a rule prevents manufacturers in third countries from shipping pre-fabricated tile bodies to Chile for finishing/glazing and packing (which sometimes can add considerable value to a product). Such two-country manufacturing processes already are used by ceramic tile manufacturers even without tariff incentives. Therefore, a strict rule of origin is essential to prevent abuse of U.S. tariff concessions by manufacturers located outside North America.

C. Protect Worker Rights, Health and Safety

Working conditions in Chile are inferior to those in the United States, particularly in the manufacturing industries. According to the "Country Reports on Human Rights Practices for 1994," the minimum *monthly* wage in Chile is about $125. While it is to be expected that wages in less developed countries are lower than those in the United States, a distinction must be drawn between competitive low wages and wage rates that are depressed because the workers are not allowed to organize or exercise basic rights. Any free trade agreement must guarantee Chilean workers the same basic rights available to U.S. workers in fact as well as in theory. Similarly, workplace safety and health protections must be guaranteed to Chilean workers on the same basis that they are guaranteed to American workers. It is not in the interest of either the United States or Chile to conclude a free trade agreement that promotes the exploitation of Chilean employees.

D. Protect the Environment

Environmental protection often is neglected in Chile, especially in the manufacturing industries. The NAFTA negotiations failed to ensure the prompt and certain harmonization of Mexican environmental laws with those of this country. That mistake should not be repeated in any negotiations with Chile. As a condition of accession, Chile should be required to raise its environmental standards to a level comparable to those in this country. The United States should not agree to lower its environmental standards. There should be a clear statement of specifics and time tables from the outset and continued access to the U.S. market should be conditioned on adherence by Chile to appropriate environmental standards. As in the case of worker rights, health and safety concerns, a failure to address the environmental issues in any NAFTA accession agreement will create a powerful economic incentive for environmental abuse in Chile at the expense of American jobs and prosperity.

V. CONCLUSION

In any accession of Chile to NAFTA, U.S. tariff treatment of ceramic tile from Chile should be no more favorable than the 15 year "C+" staging already established for ceramic tile from Mexico. The current rule of origin should be retained. Effective guarantees of worker rights and environmental protection substantially equivalent to U.S. and Canadian standards should be a pre-condition for any tariff reduction.

Dated: July 13, 1995

Robert E. Daniels
Executive Director
TILE COUNCIL OF AMERICA, INC.
P. O. Box 1787
Clemson, SC 29633-1878
(803) 646-8453

Exhibit 1

PROFILE OF U.S. CERAMIC TILE MANUFACTURING INDUSTRY

Numbers of Producers	95[1]
Employees	10,000
1992 Shipments	$640,049.000[2]

PRINCIPAL U.S. MANUFACTURERS
(Tile Council Members Shown in Bold)

Name	Headquarters	Plants
American Olean Tile Co.	**Lansdale, PA**	**Lansdale, PA** **Jackson, TN** **Olean, NY** **Lewisport, KY** **Fayette, AL**
American Marazzi Tile, Inc.	Sunnyvale, TX	Sunnyvale, TX
B&W Tile Co., Inc.	Cardena, CA	Gardena, CA
The Claycraft Company	Columbus, OH	Columbus, OH Sandusky, OH
Ceramitex, Inc.	Owossa, MI	Owossa, MI Mineral Wells, TX
Color Tile, Inc.	Fort Worth, TX	Fort Worth, TX Melbourne, AR Cleveland, MS
Continental Clay Company	Kittanning, PA	Kittanning, PA
Crossville Ceramics	**Crossville, TN**	**Crossville, TN**
Dal-Tile Corporation	Dallas, TX	Dallas, TX
Design Technics	New York, NY	New York, NY
Dura Ceramics	Sun Valley, CA	Sun Valley, CA
Endicott Tile, Ltd.	**Fairbury, NE**	**Fairbury, NE**
Epro, Inc.	Westerville, OH	Westerville, OH
Firebird, Inc.	**Berkeley Heights, NJ**	**Berkeley Heights, NJ**
Florida Brick & Clay Co.	**Plant City, FL**	**Plant City, FL**
Florida Tile Industries, Inc.	**Lakeland, FL**	**Lakeland, FL** **Lawrenceberg, KY** **Shannon, GA**

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1 Source: U.S. International Trade Commission, Industry and Trade Summary, Ceramic Floor and Wall Tiles, USITC Pub. 2504 (MM-2) (November 1992) at 3.

2 U.S. Department of Commerce, Current Industrial Reports, Series M32-D (July 1993).

Name	Headquarters	Plants
Huntington/Pacific Ceramics, Inc.	**Fort Worth, TX**	**Fort Worth, TX**
IMAC - Integrated Mosaic & Ceramic Corp.	Dickson, TN	Dickson, TN
Interceramic USA	Carrollton, TX	Carrollton, TX
K.P.T. Inc.	**Bloomfield, IN**	**Bloomfield, IN**
Kraftile Company	Fremont, CA	Fremont, CA
Laufen International, Inc.	**Tulsa, OK**	**Tulsa, OK**
London Tile Company	New London, OH	New London, OH
Lone Star Ceramics Company	**Dallas, TX**	**Dallas, TX**
Mannington Ceramic Tile	Lexington, NC	Lexington, NC Mt. Gilead, NC
Marion Ceramics, Inc.	Marion, SC	Marion, SC
Metropolitan Ceramics (Division of Metropolitan Industries, Inc.)	**Canton, OH**	**Canton, OH**
Monarch Tile, Inc.	**Florence, AL**	**Florence, AL** **Marshall, TX**
Quarry Tile Company	**Spokane, WA**	**Spokane, WA**
Seneca Tiles, Inc.	**Attica, OH**	**Attica, OH**
Stonelight Tile Company	San Jose, CA	San Jose, CA
Stoneware Tile Company	Richmond, IN	Richmond, IN
Summitville Tiles, Inc.	**Summitville, OH**	**Summitville, OH** **Minerva, OH** **Morganton, NC**
Terra Designs, Inc.	**Dover, NJ**	**Dover, NJ**
Tilecera, Inc.	Clarksville, TN	Clarksville, TN
The Tileworks	**Des Moines, IA**	**Des Moines, IA**
U.S. Ceramic Tile Company	**East Sparta, OH**	**East Sparta, OH**
Universal Quarry Tile	Adairsville, GA	Adairsville, GA
Western Quarry Tile, Inc.	Monrovia, CA	Monrovia, CA
Westminster Ceramics Inc.	Bakersfield, CA	Bakersfield, CA
Whitacre-Greer Fireproofing Co.	Alliance, OH	Alliance, OH
Winburn Tile Manufacturing Co.	**Little Rock, AR**	**Little Rock, AR**

Statement of

Toy Manufacturers of America, Inc.

On the Accession of Chile
To The
North American Free Trade Agreement

July 13, 1995

Summary

TMA enthusiastically supports Chile's accession to NAFTA. Chile has pursued exemplary macroeconomic and trade and investment policies that have led to an expansion of business opportunities for American firms in Chile and that have had an important, highly constructive demonstration effect for other emerging countries in Latin America and around the world. It is entirely appropriate that Chile be "first in line" to have the opportunity to join the NAFTA.

Negotiations to bring Chile into the NAFTA are important not only because they will establish the future conditions for U.S.-Chile trade but also because they will establish important precedents for all future negotiations with potential United States' FTA partners. TMA urges that one of the obligations that the United States require Chile and all future FTA partners assume is the *immediate* implementation of zero tariffs in sectors -- including toys -- in which the United States implemented zero tariffs upon the entering into force of the Uruguay Round agreement. The "zero-for-zero" tariff initiative of the Uruguay Round was one of the Round's most important accomplishments. It is fitting that this important initiative be continued in future U.S. trade liberalization efforts. TMA recommends that Congress make this a formal United States negotiating objective in writing "fast track" legislation.

The Toy Manufacturers of America, Inc. (TMA) is the association that represents more than 260 U.S. manufacturers, exporters, and importers of toys, games, dolls and festive articles that account for approximately 85 percent of all toy sales in the United States. These companies employ 42,000 American workers. Approximately 70 percent of these workers hold production jobs. The balance of toy industry employment is found in product design and development, production engineering and quality control, and marketing and advertising. Toys today are a $50 billion global industry at the wholesale level and America's toy companies are the leaders in inventing, designing, producing, marketing, and selling toys around the world.

TMA enthusiastically supports Chile's accession to NAFTA.

The volume of trade between the United States and Chile in toys is small. Last year, U.S. companies exported $19 million in toy products to Chile while the United States imported less than $2 million in toys from Chile. Logical economic and business considerations explain this low volume of trade. Trade barriers are not responsible. It is therefore not reasonable to expect that Chile's accession to NAFTA will trigger a dramatic increase in trade in toys between our two countries. Having said that, however, the elimination of Chile's 11 percent applied tariff on toys (and the elimination as well of Chile's GATT-bound duty rate of 25 percent) would benefit American toy producers and -- along with the increased attention that accession to NAFTA will focus on Chile -- could encourage more of them to consider marketing their products in Chile. That potential gain in business is reason enough for TMA to support Chile's accession to NAFTA.

TMA also recognizes that the stakes in Chile's accession to NAFTA far transcend trade in toys. No country in Latin America has a better record of economic accomplishment than Chile over the past decade. In fact Chile's performance -- the product of disciplined macroeconomic policies and an open trade and investment regime -- is nothing short of outstanding. No country in Latin America is better suited to be an FTA partner of the United States than Chile. If the United States objective is -- as it should be -- to encourage emerging countries in Latin America and around the world to embrace disciplined, stable, growth-sustaining economic policies and to make an unshakable commitment to open markets, TMA can think of no stronger signal to send to them than to invite Chile to participate in NAFTA. Chile's accession to NAFTA will send a clear signal to other emerging countries that economic reforms, most importantly open trade and foreign investment regimes, must be in place for them to be eligible to be considered FTA partners of the United States. At the same time, accession to NAFTA will give concrete and permanent support to Chile's return to democracy and its embrace of free market economics, both important American interests.

Expanding NAFTA to include Chile will be an important first step in building a free trade regime in the Western Hemisphere and encourage trade liberalization in the Asia-Pacific region as well. The elimination of tariffs and non-tariff distortions will enhance consumer welfare and create both new wealth and more jobs. As leaders of the global toy industry, TMA member companies, as well as American consumers, will benefit from this process.

The conditions of Chile's accession to NAFTA will set important precedents. Among them should be immediate implementation of the "zero for zero" tariff initiative pioneered in the Uruguay Round.

Chile is, of course, only the first Latin American country to apply for accession to NAFTA. Others will follow as the Administration builds upon its plan -- endorsed by Latin American leaders last December in the Summit of the Americas Declaration -- to create a Free Trade Area of the Americas (FTAA) by the year 2005. Chile also is a member of APEC, the Asian Pacific Economic Cooperation forum, the focus of another major Administration free trade initiative that leaders of the Asia-Pacific region intend to bring to fruition by the years 2010 and 2020. These dates -- the nearest one a decade away -- may appear far off in the future but they will arrive quickly. Since the negotiations that will bring Chile into NAFTA are just the start of a much larger and more ambitious trade negotiating agenda, they hold importance that transcends the immediate stakes in bilateral U.S-Chile trade. Negotiations with Chile must therefore be approached with the *strategic* importance inherent in them.

One of the many important accomplishments of the Uruguay Round of multilateral trade negotiations was the successful U.S. **"zero for zero"** tariff initiative. As a result of this initiative under which the major countries of Europe, Japan, and Canada agreed to eliminate reciprocally their tariffs across a broad range of industrial sectors -- some, as in the case of toys in the United States, on an accelerated basis -- U.S. manufacturers will enjoy the same access to foreign markets that U.S. competitors have enjoyed in selling into the United States. That, of course, is the Administration's objective in advocating free trade in Latin America through the FTAA and in the Asia-Pacific region via APEC.

In keeping with the spirit of the **"zero for zero"** initiative of the Uruguay Round, countries seeking to accede to the NAFTA or join the United States as partners in other free trade arrangements should be required to embrace the commitment to eliminate *immediately* -- upon the entering into force of any free trade arrangement -- tariffs in product sectors, such as toys, in which the United States has eliminated tariffs pursuant to the **"zero for zero"** undertaking. Lengthy staging of tariff reductions is inappropriate in these product sectors.

TMA specifically recommends that Congress establish this principle as a formal U.S. negotiating objective in any legislation to extend the President's access to "fast track" trade agreement approval procedures and/or to authorize future trade negotiations.

David A. Miller
President
Toy Manufacturers of America, Inc.
200 Fifth Avenue
New York, New York 10010

Comments of the U.S. Council for International Business on Accession of Chile to the North American Agreement on Environmental Cooperation and the North American Agreement on Labor Cooperation.

The United States Council strongly supports the Administration's initiative to open negotiations with Chile and our other NAFTA partners to permit the earliest possible agreement on Chile's accession to NAFTA. We indeed hope that Chile's accession will be just the first in a series which will eventually lead to the establishment of the Free Trade Area of the Americas which the Summit of the Americas endorsed last December.

The U.S. Council also believes that, as other U.S. trade partners in the Americas undertake commitments to enter into free trade agreements with us, there should be a concomitant expansion of programs for cooperation among our countries in a variety of other matters of concern to all the countries involved. The U.S. Council has, for example, endorsed the call in the "Agenda for the Americas" statement of September 21, developed under the auspices of the Council of the Americas, that governments "require their trade and other concerned ministers to meet annually and report back to the Summit leaders on progress made toward the goals of regional integration and enhanced cooperation on environmental, labor and other policy interests."

The U.S. Council supports, in particular, the negotiation of agreements with Chile, (and eventually other Latin American countries joining us in free trade arrangements) which provide for programs of enhanced cooperation to promote both environmental protection and the advancement of the rights and interests of workers in all our societies. However, while we favor such agreements implemented through appropriate institutions, we also recommend that, in acceding to NAFTA, Chile should not be required to accede to the environmental and labor side agreements as reached with Mexico and Canada in 1993.

American business accepted the current NAFTA side agreements because the close proximity and intensity of the economic and social relationships among the U.S., Canada and Mexico arguably did require more comprehensive agreements. This rationale does not hold for any other free trade candidates, either in this hemisphere or elsewhere. (We note, for example, there are not, and should not be, agreements of the character of the NAFTA side agreements with our other free trade partner, Israel.)

The U.S. Council strongly supports the cooperative aspects of current NAFTA side agreements. Any comparable side agreement with Chile or other future NAFTA partners should concentrate on encouraging and enhancing such cooperation (including private sector-to-private sector voluntary projects). We also support the cooperative dispute avoidance role of the Joint Public Advisory Committee to the North American Commission on Environmental Cooperation and would favor a similar arrangement with Chile.

However, any such arrangement should not contain coercive or confrontational features. The U.S. Council is particularly opposed to the incorporation of any form of trade sanction to enforce environmental or labor standards or behavior as they run counter to the objectives of NAFTA. The U.S. Council firmly believes that building cooperative programs to promote regional integration and enhanced cooperation in environmental and labor issues is the primary objective to be pursued in any side agreement, and provides the greatest opportunity for lasting achievements.

HOUSE WAYS & MEANS COMMITTEE

STATEMENT OF THE WARNER-LAMBERT COMPANY REGARDING CHILE'S PROSPECTIVE ENTRY INTO THE NORTH AMERICAN FREE TRADE AGREEMENT

July 13, 1995

This statement is submitted by the Warner-Lambert Company in accordance with the House Ways & Means Committee's request for comment regarding the proposed accession of Chile to the North American Free Trade Agreement (NAFTA).

Warner-Lambert is a U.S. corporation, headquartered in Morris Plains, New Jersey, with sales exceeding $6 billion in 1994. Our company is engaged in the research and development, manufacturing and marketing of quality health care and consumer products. Warner-Lambert's pharmaceutical business is focussed on the major therapeutic areas of cardiovascular disease, central nervous system disorders and anti-infective chemotherapy. Our consumer products include over-the-counter pharmaceuticals, health care related personal products, pet care products, confectioneries including chewing gums and breath mints, and shaving products including razors and blades.

Warner-Lambert wishes to express its strong support for Chile's accession to the NAFTA. We believe this to be an important objective in its own right, and an important step towards the establishment of a free trade agreement covering the rest of Latin America as envisioned in the Free Trade Area of the Americas (FTAA) initiative. However, Warner-Lambert believes that the protocol for Chile's accession to the NAFTA must include strong commitments from Chile regarding intellectual property protection and market access as outlined below.

Intellectual property protection

A priority objective for Warner-Lambert in the NAFTA accession negotiations with Chile, as in any trade negotiations, is the establishment of strong intellectual property protection. Chile's 1991 patent law is deficient in key areas, including an inadequate patent term of 15 years from grant and a lack of pipeline protection. Also, the Chilean health registration system, through Decree Law 435, discriminates against innovations of pharmaceutical products by allowing national laboratories to copy products under registration requirements that are much less stringent than those required for the innovator (for example, the national laboratories are not required to submit such key scientific/chemical documentation as the clinical monography and active ingredient standards). In addition, Chile's patent registration periods are structured in a way that significantly favors national laboratories.

Warner-Lambert also wishes to stress the importance of securing from Chile a high level of protection for trademarks, trade secrets and copyrights. Our understanding is that Chile has no law providing direct protection of trade secrets, a deficiency that must be corrected in the country's NAFTA accession protocol.

Finally, it is critical that the protocol commit the Chilean government to undertake the activities necessary to ensure that the intellectual property rights protected under the agreement are fully enforced. In this regard, we request that Congress urge the Administration to incorporate into the agreement a provision for ongoing monitoring of Chile's enforcement obligations.

Market access

Warner-Lambert requests the immediate or expedited elimination of Chile's 11 percent *ad valorem* rates of duty on several categories of key export interest to the company's U.S. and Canadian operations. These products enter Chile under the following tariff categories, each of which has a most-favored-nation rate of duty of 11 percent *ad valorem*.

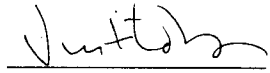
HS subheading	Brief description of Warner-Lambert product
1505.90.00	Lanolin
1519.11.00	Stearic acid
1704.10.00	Dentyne group, Trident group, Freshen Up
1704.90.10	Clorets Minimints
2818.30.00	Aluminum hydroxide and magnesium
2905.17.00	Cethyl alcohol
2933.39.01	Hexetidine
3004.90.10	Cognex (Tacrine), Dilantin (Phenytoin)
3001.20.00	Hog bile
3910.00.00	Antifoam
8212.10.00	Extra II razor
8212.20.00	FX 5 razor blades
9602.00.00	Gelatin capsules

In addition, Warner-Lambert also urges that Chile be required to commit to an across-the-board elimination of its duties on all pharmaceutical products. This is required for reasons of reciprocity since, effective January 1, 1995, the United States completely eliminated its most-favored-nation (MFN) duties on all pharmaceuticals as part of the zero-for-zero deals struck in the context of the Uruguay Round of multilateral trade negotiations. However, few developing countries participated in the zero-for-zero arrangements and it is critical that the Administration redress this imbalance by insisting, *inter alia*, that all new members of the NAFTA, and other free trade agreements to which the United States is a party, commit to the immediate elimination of their tariffs in all zero-tariff sectors.

Conclusion

Warner-Lambert strongly supports Chile's accession to the NAFTA provided the accession protocol satisfies the intellectual property and market access objectives outlined above. Chile's NAFTA accession will promote Warner-Lambert's competitiveness in the Chilean market by reducing the costs of a range of NAFTA-originating products manufactured by Warner-Lambert in the United States and Canada. It is also hoped that a commitment by Chile to undertake to the requested reforms will serve as an important precedent to be followed by subsequent NAFTA accession candidates.

Respectfully submitted,



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THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CUBA AFTER CASTRO

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JUNE 30, 1995

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THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CUBA AFTER CASTRO

FRIDAY, JUNE 30, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 1100, Longworth House Office Building, Hon. Philip M. Crane (chairman of the subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
June 14, 1995
No. TR-12

CONTACT: (202) 225-1721

Crane Announces Hearing on the Economic Relationship Between the United States and Cuba After Castro

Congressman Philip M. Crane (R-IL), Chairman, Subcommittee on Trade of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the economic relationship between the United States and Cuba after the fall of the Castro government. **The hearing will take place on Friday, June 30, 1995, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

BACKGROUND:

Cuba is the most populous of the Caribbean nations with an estimated population of 11.1 million people with a gross national product of $13.7 billion. At the present time, major Cuban imports include petroleum, food, machinery, and chemicals. Major Cuban exports currently include sugar, nickel, shellfish, tobacco, medical products, citrus, and coffee.

Specific authority for a total trade embargo on Cuba is contained in section 620(a) of the Foreign Assistance Act of 1961. In 1992, Congress passed the Cuban Democracy Act to tighten the embargo in certain respects and to direct the President to take several actions, including steps to end the trade embargo, to assist a freely and democratically elected Cuban government, should one come to power.

In announcing the hearing, Chairman Crane stated: "Because Cuba is located so close to U.S. shores, it appears to be a natural market for U.S. trade and investment after the fall of the Castro government. At present, the United States enjoys a surplus in our trade relations with our other neighbors in the Caribbean Basin. I look forward to this opportunity to examine the possibilities for mutually beneficial trade and economic relations with Cuba in the post-Castro era."

FOCUS OF THE HEARING:

The focus of the hearing is to examine the economic relationship that is likely to develop between the United States and Cuba after the fall of communism in Cuba.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Wednesday, June 21, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Trade will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-6649.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Trade office, room 1104 Longworth House Office Building, no later than 10:00 a.m. on Wednesday, June 28, 1995.** Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Friday, July 14, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Trade office, room 1104 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

*****

Chairman CRANE. Folks, we are going to be on a tight time constraint today, and I know several of our witnesses have other committee assignments.

I was informed that there may be a journal vote, God forbid. If not a journal vote, though, there will be a rule vote probably coming up in the neighborhood of 10:30 to 10:35 a.m.

And let me also remind our witnesses that we would appreciate it if you would confine your oral comment to 5 minutes. If you have anything more, it will all be inserted in the record, however.

And today I am pleased that the Subcommittee on Trade will hear testimony on the economic relationship between the United States and Cuba after the fall of the Communist dictatorship of Fidel Castro.

This is a hearing that was scheduled many weeks ago and is not associated with any legislative initiatives.

We have a full schedule today, so we are going to attempt to conclude today's hearing by 2:30 p.m. to enable Members to make their commitments this evening in their districts, assuming we get out of here.

As a result, I would like to again remind you that any written remarks you have beyond your presentations will be a part of the record.

Because of its proximity to U.S. shores, a free and independent Cuba would be a natural market for U.S. trade and investment. At present, the United States enjoys a trade surplus in our relations with our other neighbors in the Caribbean. If these figures are indicative of the trade that could develop between the United States and Cuba, then a liberated Cuba with nearly 12 million citizens has the potential to become an important export market for U.S. goods.

Recognizing that many foreign companies already have a presence in Cuba that U.S. companies are denied, I believe it is important for the subcommittee today to examine what the position and possibilities will be for U.S. companies when the day comes that they can conduct business again with Cuba.

I look forward to hearing today's testimony from our witnesses, and we are going to pause briefly here for our distinguished ranking minority member, who is en route, and I would like to have him welcome the members of the committee here.

Let me also say in anticipation, there is a little light in front of Congressman Burton there—and is this not a shocker [laughing]?

Well, I think, folks, what we might do is recess the committee, go over there and make that journal vote, and then we will come right back, because I am sure that Mr. Rangel will be here by then.

But let me add just one other thing, because I know Congressman Burton and Congressman Torricelli, Congresswoman Ros-Lehtinen and Congressman Menendez, you have committee hearings, too, I guess.

Mr. BURTON. Yes, Mr. Chairman, we do at 11 o'clock and Lincoln Diaz-Balart as well.

Chairman CRANE. Well, for that reason, we will let you folks go first.

Mr. BURTON. OK.

Chairman CRANE. But let us break now, go make the journal vote, and then come back, and then we will have Congressman Rangel make a quick presentation, and then you folks can commence.

Mr. COYNE. Mr. Chairman.

Chairman CRANE. Yes.

Mr. COYNE. I ask unanimous consent to have my statement included in the record.

Chairman CRANE. Without exception, so ordered.

[The prepared statement follows:]

THE HONORABLE WILLIAM J. COYNE
TESTIMONY FOR
THE SUBCOMMITTEE ON TRADE
THE HOUSE COMMITTEE ON WAYS AND MEANS

JUNE 30, 1995

Mr. Chairman, today I want to testify on the subject of a future economic relationship between the United States and Cuba.

I want to begin by stating that I support the democratic aspirations of the Cuban people and their right to create a society of their own in which there is respect for political freedom and human rights. I also support efforts to promote economic growth and stability in Cuba that would bring about a general improvement in the living standard of the Cuban people. Achieving progress in both political and economic freedoms would benefit the Cuban people and would also alleviate the conditions which have led some Cubans to attempt to enter the United States by sea illegally and at great personal risk. These are goals which I believe are shared by most Americans and by many Members of this Congress.

The question is how does the United States advance these goals in the most effective manner while still respecting international law and the right of the Cuban people to determine their own future. I believe that it is time for the United States to re-examine its current Cuba policy in light of the fact that our current policy has failed to promote political or economic freedom in Cuba. The present Cold War-based system of sanctions against Cuba has failed on many levels. Efforts to isolate Cuba internationally have had little success and are not supported by most of our fellow industrial democracies around the world. Sanctions have also given the current communist regime in Cuba an excuse for its failed economic policies. Finally, the interventionist nature of current U.S. foreign policy against Cuba has enabled Fidel Castro and his supporters to play upon the nationalistic feelings of the Cuban people to justify a denial of political and economic liberty.

S. 381 would perpetuate and intensify this failed U.S. policy toward Cuba. The likely results of this legislation would be a renewed exodus of illegal Cuban immigrants to the United States. S. 381 would also give renewed life to the Castro regime's efforts to claim a nationalistic legitimacy in the face of United States intervention. As a result, the Cuban people would continue to suffer from extreme poverty and deprivation while being denied human rights and political liberty.

As a Member of the House Ways and Means Subcommittee on Trade, I want to comment specifically on certain provision in S. 381 which would seek to impose the current U.S. embargo against Cuba on third nations. This effort to impose trade and other legal sanctions on third parties who do not agree with the current U.S. Cuba policy is ill-advised and dangerous to our relations with the rest of the world. More importantly, the third-party trade sanctions in this legislation are dangerous to the economy of the United States and the jobs of American workers.

Prohibiting the importation of goods from third countries that do business with Cuba would almost certainly violate U.S. international treaty obligations under GATT and NAFTA. Attempts to enforce third party sanctions would invite retaliation from our foreign trading partners and would put American jobs at risk. Prohibitions on U.S. individuals and/or businesses conducting trade with third parties who do business in Cuba would place American businesses at a severe disadvantage. Finally, disrupting U.S. trade relations with the nations of Europe, Asia and the Americas over the issue of Cuba would also divert our Nation's attention from important bi-lateral and multi-lateral trade issues.

The third-party trade sanctions in this legislation attempts to make a failed bi-lateral policy between the United States and Cuba an international matter that would overtake all other U.S. foreign policy interests. The only result of attempting to enforce these provisions of S. 381 would be to demonstrate unequivocally that the United States policy toward Cuba is not supported by the international community.

The idea of imposing U.S. policy toward Cuba on third nations through the use of trade sanctions is folly and doomed to failure. I believe that the United States should be pursuing a more constructive policy of promoting liberalization in Cuba. Part of this effort should include support for non-governmental groups in Cuba that support human rights and political liberty. The United States should also be promoting regular contact between the American people and the Cuban people so that a more positive relationship between our nations can be promoted. Finally, the United States should abandon the current embargo strategy that has failed to achieve its goals over several decades. Taking this action will remove one of the central excuses used by the Castro regime to justify its violations of the political and human rights of the Cuban people.

Mr. Chairman, it is time for a serious re-evaluation of U.S. policy toward Cuba. The United States can do far better in promoting freedom in Cuba by engaging the Cuban people in direct contact than by pursuing a failed policy of isolation. I oppose S. 381 but I do hope that consideration of this legislation will prompt the American people to re-examine U.S. relations with Cuba.

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[Recess.]

Chairman CRANE. Folks, I think we will proceed because of the time constraints, and when Mr. Rangel gets here at the termination of the presentation of the witnesses speaking at the time he arrives, we will let him make introductory remarks, and also Mr. Shaw.

And so with that, I would like to start today's testimony with Congressman Dan Burton.

STATEMENT OF HON. DAN BURTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. BURTON. Thank you very much, Mr. Chairman, for your invitation to appear this morning before your committee and to testify on this very critical matter.

I am not of Cuban heritage, nor do significant numbers of Cuban-Americans reside in my district. Yet the issue of Cuba has moved and energized me as a Member of Congress as few other issues have.

When our Founding Fathers wrote the Declaration of Independence, they specifically stated that: "All men are created equal." They did not say that only Americans are created equal.

It has long been part of the American credo that the rights and privileges of freedom and democracy are the inheritance of all mankind. Ours has always been a missionary quest in the sense that we have always believed that our good fortune and blessings should be extended wherever possible to our fellow man.

It is for this reason that America has been at the forefront of the struggle for freedom and democracy worldwide. This was the case in Europe in World War II. It was the case in Korea, and, yes, it was the case in Vietnam.

It is precisely because of this precious legacy of promoting freedom that we should all be concerned about what is happening in Cuba. Right there, a mere 90 miles from America's shore, an entire people is enslaved. If a threat to freedom anywhere is a threat to freedom everywhere, then we should all be even more offended when the denial of freedom occurs so close to U.S. shores.

There is no doubt, Mr. Chairman, that Cuba under Fidel Castro is one of the most repressive regimes in the world today. Just read the State Department's Human Rights Report or the U.N. Human Rights Commission Report or Amnesty International or Human Rights Watch.

Cuba used to be one of the wealthiest countries in Latin America in terms of per capita income. Today it is the poorest.

Why? Not because of the embargo. Cuba was always able to get what it needed elsewhere. The only reason for the collapse of the Cuban economy is the 36-year-old dictatorship of Fidel Castro with its attendant mismanagement and repression.

Yet despite the abject failure of communism in Cuba and everywhere else, Fidel Castro has not changed a bit. His motto is still "Socialism or Death."

There is simply no moral or practical choice, Mr. Chairman, but to keep the pressure on Castro, and, in fact, to increase it as much as possible. We owe it to the Cuban people, but also to ourselves.

First, because it is the right thing to do; second, because Cuba, once it is freed from its shackles, holds tremendous potential both for its own people and for American investors.

Over 20,000 Cubans currently in Guantanamo serve as tragic and graphic witnesses to the misery and suffering that Fidel Castro has inflicted on his own people. Why else would they all risk life and limb to get away?

Removing Fidel Castro and his dictatorial regime would relieve the pressure of so many thousands attempting to flee. It would unleash the creative and entrepreneurial spirit of the Cuban people, and it would open a new market for its natural and historic trading partner, the United States of America.

Mr. Chairman, the U.S. embargo on Cuba is succeeding. Since the end of $6 billion a year in Soviet subsidies and since the passage of the 1992 Cuban Democracy Act, Fidel Castro has become desperate for foreign capital. That capital is his lifeline, and we must be determined to deny it to him. His time is up, and the Cuban people have suffered long enough.

Fidel Castro is begging us for a lifeline. I say, Mr. Chairman, that we throw him an anchor instead.

Thank you, Mr. Chairman.

Chairman CRANE. Thank you, Congressman Burton.

We are going to only have time, I think, for Congressman Torricelli, because, as you know, there is another vote in progress.

I might counsel you in advance. It is a motion to adjourn, and if we adjourn over there, we will not have any further interruptions.

Wait just a moment. Our distinguished ranking minority member is here. So, Congressman Torricelli, I would like to yield to Congressman Rangel to make an opening statement before your testimony.

Mr. RANGEL. Mr. Chairman, I hope to be brief. I have never seen a more controversial subject come before the U.S. Congress, and yet I have never seen such sincere, dedicated Members of Congress that all want the same objectives, and that is democracy for all, especially those that are so close to our country, as in Cuba.

There are those that believe that the embargo and strengthening it is the way to go. And now we are trying to find out what happens after Castro. I think a lot happens as to what we do before Castro, as other countries are attempting to get ahead of the curve and establish trade relationships.

What happens if the Helms-Burton bill passes and is effective? I think that it would test the friendships and the trade relationships we have with friends. And no one believes that it ever will become law.

And so, Mr. Chairman, as we move toward "after Castro," who takes over? Is there revolution? Do we know the person? Can we do business with him? These are very serious questions.

Meanwhile we deny food and medicine to the poor people in Cuba, and we deny opportunity to many people, including Cuban-Americans, from doing business with Cuba.

I think it is a poor policy. But to get back to the main theme, it is what can we do together to assure that Cuba would have freedom and democracy as she deserves?

And I look forward to the testimony and again working with those that share the same goals, even though we have different views as to how they are to be achieved.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT BY
HON. CHARLES RANGEL

THE ECONOMIC RELATIONS BETWEEN THE U.S. AND CUBA
AFTER THE EMBARGO

COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE

JUNE 30, 1995

I WANT TO THANK CHAIRMAN CRAIN FOR CALLING THIS IMPORTANT HEARING.

I UNDERSTAND THAT THIS HEARING HAS BEEN CALLED TO CONSIDER ECONOMIC RELATIONS BETWEEN THE U.S. AND CUBA AFTER CASTRO. SINCE WE HAVE NO IDEA WHAT THE NATURE OF THE CUBAN GOVERNMENT WILL BE ONCE CASTRO HAS LEFT, I WOULD PREFER TO CONSIDER THE ISSUE OF OUR ECONOMIC RELATIONS AFTER THE U.S. EMBARGO IS LIFTED.

FRANKLY, I WOULD HOPE THAT THIS CONGRESS WOULD SUPPORT THE PRESIDENT IN A MOVE TO LIFT THE EMBARGO AS SOON AS POSSIBLE. IT IS MY VIEW--AND I KNOW THAT IT IS SHARED BY MANY CUBAN-AMERICANS AS WELL AS MY COLLEAGUES IN CONGRESS--THAT ENDING THE EMBARGO WOULD DO MORE THAN ANYTHING ELSE TO PROMOTE DEMOCRACY IN CUBA AND TO HASTEN CASTRO'S DEPARTURE.

I HAVE NO LOVE FOR DICTATORS, COMMUNIST OR RIGHT WING. BUT IT MAKES NO SENSE FOR US, AS THE WORLD'S MOST POWERFUL NATION, TO PURSUE A POLICY THAT MAKES VICTIMS OF 11 MILLION INNOCENT PEOPLE BECAUSE WE HATE THE GOVERNMENT THEY LIVE UNDER.

IT IS SAD TO SAY THAT OUR CURRENT POLICY IS ONE OF TIGHTENING THE NOOSE--THAT IS A TERM USED BY SUPPORTERS OF THE EMBARGO. IT MEANS ATTEMPTING TO STARVE THE CUBAN PEOPLE INTO REVOLT AGAINST A POWERFUL WELL-FED ARMY. THE ONLY RESULT WOULD BE SLAUGHTER AND BLOODSHED--AND FOR THOSE WHO SURVIVE--REFUGE ON THE SHORES OF FLORIDA.

I FIRMLY BELIEVE THAT AS A GREAT NATION WE CAN DO BETTER. WE COULD SHOW OUR LEADERSHIP AND CONFIDENCE IN OUR OWN DEMOCRATIC FREE-ENTERPRISE SYSTEM. WE COULD PUT IN PLACE A POLICY OF MASSIVE ENGAGEMENT.

WHY NOT FLOOD CUBA WITH AMERICAN GOODS, WITH CULTURAL EXCHANGES, WITH STUDENTS, WITH NEWS AND INFORMATION. SHOW THEM THE FRUITS OF DEMOCRACY. BY DOING THAT WE WOULD CREATE A GREAT WAVE OF YEARNING FOR A BETTER WAY OF LIFE--A YEARNING THAT IS ALREADY PRESENT BUT NEEDS TO BE NURTURED, NOT STARVED BY A COUNTERPRODUCTIVE EMBARGO.

SOME WOULD CALL THAT NAIVE. BUT THAT'S HOW WE WON THE COLD WAR IN EASTERN EUROPE AND THE SOVIET UNION. AND IF WE WERE VICTORIOUS AGAINST THESE NATIONS WHICH WERE FORMIDABLE MILITARY THREATS TO US AND OUR ALLIES, WHY SHOULD WE FEAR CUBA?

I HAVE ASKED THIS QUESTION MANY TIMES. IF FOR SOME REASON WE INSIST ON KEEPING THE EMBARGO, WHY CAN'T WE EXEMPT FOOD AND MEDICINE? AS AN AMERICAN I AM EMBARRASSED TO SAY THAT WE HAVE NEVER IMPOSED AN EMBARGO ON FOOD AND MEDICINE ON ANY OTHER NATION. HOW CAN WE SUPPORT A POLICY SO INHUMANE THAT VOLUNTEERS AND CHURCHES ARE FORCED TO COMFORT THE SICK AND HUNGRY VICTIMS.

I COMMEND CARDINAL O'CONNOR OF NEW YORK WHO JOINED ME LAST YEAR IN SENDING $2.5 MILLION IN MEDICINES AND ANTIBIOTICS TO CUBA. BUT WHY SHOULD IT TAKE MASSIVE EFFORTS OF THIS KIND BY PRIVATE CITIZENS WHEN OUR MAJOR COMPANIES ARE PREPARED TO SELL THE CUBANS WHATEVER THEY NEED--AT BETTER PRICES THAN THEY ARE FORCED TO PAY NOW.

TO THOSE WHO WOULD SAY THAT OUR POLICY WILL WEAKEN THE CUBAN GOVERNMENT FASTER, I CAN ONLY REPORT THAT I HAVE NEVER SEEN A HUNGRY-LOOKING CUBAN GOVERNMENT OFFICIAL. BUT I'VE SEEN MANY HUNGRY CUBANS WASH UP ON THE SHORES OF FLORIDA.

MR. CHAIRMAN, OUR CURRENT POLICY FAILS, NOT ONLY ON HUMANITARIAN GROUNDS. WE ARE OUT OF STEP WITH THE REST OF THE WORLD COMMUNITY, WHERE IN THE UNITED NATIONS OUR EMBARGO HAS BEEN REPEATEDLY--AND NEARLY UNANIMOUSLY--CONDEMNED. AND AS I LEARNED IN MEETINGS WITH THE EUROPEAN PARLIAMENT IN BRUSSELS THIS SPRING, ANY FURTHER EFFORT TO EXTEND THE EMBARGO INTERNATIONALLY--AS PROPOSED IN THE HELMS-BURTON BILL--WILL INVITE BITTER OUTCRIES FROM OUR ALLIES.

CANADA AND MEXICO, OUR PARTNERS IN NAFTA, HAVE COMPLAINED TO THIS COMMITTEE THAT THE SECONDARY BOYCOTT CONTAINED IN THE BILL WOULD BE VIOLATIONS OF THE TRADE PACT. WE ARE SETTING OURSELVES UP FOR CONFRONTATIONS WITH OUR CLOSEST ALLIES AND TRADING PARTNERS THAT COULD HURT OUR OWN EXPORTING COMPANIES.

MR. CHAIRMAN, IT IS AMAZING TO ME, AND I WOULD THINK TO MEMBERS OF THIS COMMITTEE, THAT AT A TIME WHEN OUR GOVERNMENT HAS MADE TRADE THE HALLMARK OF OUR FOREIGN POLICY, WE WOULD PERSIST IN AN EMBARGO THAT DENIES AMERICAN COMPANIES AT LEAST $2 BILLION A YEAR IN TRADE OPPORTUNITIES.

EVERY DAY THAT WE DELAY IN REMOVING THE EMBARGO, WE DECREASE THE LIKELIHOOD OF OUR OWN COMPANIES COMPETING SUCCESSFULLY FOR BUSINESS IN CUBA. WHY? BECAUSE OUR ALLIES ARE INVESTING AND TRADING--RELISHING IN THE ABSENCE OF AMERICAN COMPETITION.

AS OF TODAY, MORE THAN 100 COMPANIES FROM 30 COUNTRIES HAVE ANNOUNCED $4 BILLION IN INVESTMENTS IN MINING, AGRICULTURE, TOURISM, BIOTECHNOLOGY, TEXTILES AND LIGHT MANUFACTURING. JAPAN, ITALY, GERMANY AND FRANCE ARE SELLING SEVERAL THOUSAND VEHICLES A YEAR. VIETNAM, CHINA AND THAILAND ARE SELLING ABOUT 350,000 TONS OF RICE A YEAR. THAT IS 15 PERCENT OF CURRENT U.S. RICE EXPORTS.

MR. CHAIRMAN, THE PRESIDENT HAS TAKEN A STEP TOWARD A SANER IMMIGRATION POLICY TOWARD CUBA. NO LONGER WILL ILLEGAL HIJACKERS AND RAFTERS BE WELCOMED AS HEROES AS THEY WERE IN THE PAST. INSTEAD, CUBANS WILL BE GRANTED THE 20,000 VISAS ALLOCATED EACH YEAR FOR LEGAL ENTRY.

THAT IS A STEP IN THE RIGHT DIRECTION. I WOULD ONLY URGE THE PRESIDENT--AND WOULD CALL ON THIS CONGRESS TO SUPPORT HIM--TO MOVE FORWARD ON THOSE POSITIVE STEPS ALLOWED UNDER CURRENT LAW. FIRST, HE SHOULD IMMEDIATELY REMOVE ALL RESTRICTIONS ON FOOD AND MEDICINE. HE SHOULD LIFT THE RESTRICTIONS ON TRAVEL TO CUBA FOR ALL AMERICANS. AND HE SHOULD ENCOURAGE THE FREE FLOW OF INFORMATION TO AND FROM THE ISLAND BY ESTABLISHING MUTUAL NEWS BUREAUS.

INDEED, TO ALL OF MY COLLEAGUES WHO VOTED FOR THE CUBAN DEMOCRACY ACT, I WOULD URGE YOU TO SUPPORT THE PRESIDENT AS HE WORKS TO IMPLEMENT THE POSITIVE PROVISIONS OF THE LAW.

THANK YOU, MR. CHAIRMAN.

Chairman CRANE. Thank you, Mr. Rangel.

And with that, Congressman Torricelli, you may make your presentation.

STATEMENT OF HON. ROBERT G. TORRICELLI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. TORRICELLI. Thank you, Mr. Chairman, and thank you for this opportunity and your leadership in holding this hearing, the members of the committee, and particularly to your ranking member, Mr. Rangel. Mr. Rangel and I have had this debate on Cuba many times.

Though usually with the homefield advantage of being on the Internationl Relations Committee, it is indeed an honor today to be here at an away game and to have this opportunity again.

Mr. Chairman, it is only fitting, of course, that this hearing be held today only 1 hour before the International Relations Committee begins consideration of the Cuban Liberty and Solidarity Act, because only through this legislation—and indeed its predecessor, the Cuban Democracy Act—will we ever get to the point of normalizing economic and political relations and the Cuban people reaching their full potential.

Therefore, if only for a moment, it is necessary to talk history and current policy before we look to the economic future of our respective peoples.

The economic embargo is not designed to hurt the Cuban people. It is not designed to punish American business. It is designed for only one purpose, to end the dictatorship and to bring freedom to the people of Cuba. It is in the spirit of the international embargc against South Africa and Rhodesia and the spirit of Jackson-Vanik to free Soviet Jews. It is the use of economic pressure for a specific political and human rights objective. It is something of which all Americans should be proud.

It is nevertheless argued that after 35 years of embargo against Cuba, Fidel Castro remains. Some conclude that as a sign of failure.

Nothing, indeed, Mr. Chairman, could be further from the truth. The embargo is not 35 years old; it is less than 3 years old. Until the Cuban Democracy Act was passed in 1992, subsidiaries of American corporations were free to trade with Cuba through Europe. The embargo had no substance. That, coupled with massive Soviet aid, meant that Fidel Castro did not need to reform. He did not have to institute any changes. He lived off the largess of our corporations and their aid.

Others argue that the embargo is simply an anachronism of the cold war, that Cuba is no longer a threat to the United States.

This, too, Mr. Chairman, could not be further from the truth. It may no longer be a base of Soviet operations, but Cuba is a threat against things that we hold much more dear. It is a threat against all of our values and the causes of human rights and freedom that we championed long before the cold war began.

With that, Mr. Chairman—Mr. Chairman, would you like me to suspend now for the vote? This might be an opportune time to suspend.

Chairman CRANE. Well, if you are finished with your testimony.

Mr. TORRICELLI. I am not. But I would like to vote, too, and I——

Chairman CRANE. You can conclude your testimony. And the others, I think, are on their way back already.

Mr. TORRICELLI. I do not know that I can conclude by the time the vote is going to—I would suspect we are down to probably 4 minutes, are we not?

Chairman CRANE. No, no. We have got, I think, about 8 minutes left.

Mr. TORRICELLI. OK. I will proceed, then, Mr. Chairman.

The question, then, is what will our relationship look like with Cuba after the end of the dictatorship?

History would provide some guide. Before the revolution Castro led and betrayed, Cuba not only had the highest living standard in Latin America; it was economically integrated into the life and the culture of the United States. As our closest Caribbean neighbor, with a population of over 11 million people, its current $37 billion gross domestic product is a fraction of what would have been reached without the revolution.

One can anticipate that with a normalization, Cuba will return to becoming a major trading partner of the United States and attracting massive amounts of capital from the United States, Europe, and Latin America.

Indeed, I think it can be anticipated that with the return of millions of American tourists, a cultural center for Latin America, and attracting massive amounts of capital, the economic growth of Cuba post-Castro will probably be unmatched by any other economic experience in the hemisphere. It will be something akin to the experience of Eastern Germany attracting massive amounts of European capital and investment.

Mr. Chairman, I believe the Cuban Democracy Act has set the foundation for this postrevolutionary experience. We have authorized discussions of Cuba joining into NAFTA, the free trade area of North America, so that no time is lost in full economic integration.

It is, however, necessary that this committee, your committee, stand with us in these final months. The final added elements of pressure that are required is to ensure that Fidel Castro cannot buy more time by selling the assets of the Cuban people, selling stolen property from Americans that was confiscated during the revolution, to buy resources to get more time for his dictatorship.

The legislation——

Mr. SHAW [presiding]. Mr. Torricelli.

Mr. TORRICELLI. I will conclude in just a moment, Mr. Chairman.

The legislation before our committee today and your committee in the coming days will prohibit Fidel Castro from living off this largess. We need you to stand with us. I hope we can call upon you to do so.

Mr. Chairman, in the interests of time, I will conclude at this point.

Mr. SHAW. Mr. Torricelli, there is a vote on the floor, and you are going to have to hurry to make it.

Mr. TORRICELLI. OK, thank you.

Mr. SHAW. We thank you for your very good testimony. As usual, you are very much supportive of the objectives of our country with regard to Cuba and very much with the Cuban democratic effort.

While we are waiting for the other Members to return from the vote that is currently on the floor, I have an opening statement that I would like to read.

First of all, I would like to thank the Chairman for having this most important hearing. Today's hearing will provide this committee with an opportunity to listen to the different scenarios which could develop as a result of establishing trade relationships with Cuba after Castro is gone.

As a native south Floridian, I am keenly aware of the history of Cuba. Cuba was once a thriving nation. It had beautiful hotels and pristine beaches. It had the lowest rate of inflation of any Latin-American country and the third highest per capita income. Havana was just beginning to again emerge as a major trading port in the Caribbean, and its financial potential was just being realized when Castro seized power and snuffed out this entrepreneurial spirit.

Today Cuba's economy is the basket case of the Caribbean. Communist economics, the collapse of the Soviet Union, and the U.S. trade sanctions have caused Cuba's economy to decline an estimated 50 percent over the past few years. Castro has been forced to accept some economic reforms and loosen restrictions on private businesses.

Foreign investors are establishing footholds in Cuba and in the Cuban markets, and Castro has even gone so far as to let prices be set by supply and demand on some consumer products.

In spite of these reforms, I do not believe that Castro will last much longer.

Mr. Chairman, you have taken the correct position of continuing to support the Cuban embargo. Now is not the time to provide any type of economic assistance to Castro. To do so would be wrong and would defeat the objectives of the United States.

Some say that by lifting the economic embargo, we would expose the Cuban people to U.S. citizens, information, and goods and services, all which have a significant impact of bringing about change in Cuba by opening up the island to outside influences.

They are wrong. To lessen the pressure on a gasping Castro would be a mistake, because it would provide Castro with the needed foreign exchange to keep the economy afloat, essentially enabling him to stay in power and the existing suffering of the Cuban people to continue.

With the fall of the Soviet Union and the resulting cutoff of the massive foreign aid to Cuba, the efforts of the U.S. embargo are only now beginning to be felt.

President Clinton was correct to tighten the embargo last year, which further isolated Castro's regime. We must now stand firm.

In the meantime, we need to prepare ourselves to normalize relations with Cuba once Castro is gone, and this hearing is an excellent starting point.

I believe that Cuba will once again be a major trading partner with the United States. Its proximity to the United States, its strong historical ties with our country, and the strong character of

the Cuban people will all help to restore Cuba to its once prosperous former self.

I would like to thank again the chairman of this committee for holding this important hearing, and I look forward to returning to a Castro-free Cuba soon.

At this time, we have some more of our colleagues, a couple that know perhaps more about Cuba than us, in that they are now American citizens, but were born on the island of Cuba.

I would first like to recognize Hon. Ileana Ros-Lehtinen, a Member of Congress from Florida.

STATEMENT OF HON. ILEANA ROS-LEHTINEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Ms. ROS-LEHTINEN. Thank you, Mr. Shaw.

Throughout most of this century, the United States was Cuba's major economic partner, participating in virtually every sector of the Cuban economy. The United States was a player in sectors such as tourism and sugar and in the service sectors of the economy of the Caribbean island.

Thanks in part to this investment from the United States, as well as the strong entrepreneurial spirit of the Cuban people, the island of Cuba quickly became a center for trade in the Americas. Cuba not only enjoyed healthy economic growth, but also counted with a Constitution with one of the most progressive political, labor, and health laws in the Americas. Little could stop the partnership of prosperity which linked, through geographical location and common work and economic philosophies, the ties within Cuba and the United States.

Unfortunately there was one repressive force which not only served to sever these ties, but also destroyed the development which Cuba was making, and that is Castro communism.

The advent of this cruel and tyrannical dictatorship of Fidel Castro led the way toward the inevitable destruction of the close political and economic ties between our two countries.

With the help of the Soviet Union, Castro has attempted to destroy the incentive for the Cuban people to work. Through the abolition of private property, he illegally and immorally confiscated and indeed stole property from foreign citizens, many of them Americans, and, of course, mostly from the Cuban people themselves.

After 36 years of this Socialist experiment, which has failed, there is no doubt in anyone's mind that the Castro revolution has been a complete and total disaster. Yet Cuba and its people continue to suffer under the thumb of Castro and his repressive regime.

However, we must look ahead toward a new dawn in Cuba where liberty and democracy once again flourish in the land of Marti.

Today, in the International Relations Committee, we are poised to help expedite the coming of that dawn when we expect to approve in the full committee and send to the House floor the Helms-Burton bill.

This legislation addresses the influx of foreign investment to the island of Cuba for investors who are indifferent to the plight of the Cuban people. This legislation would not permit those investors to

conduct business in the United States if they choose to commerce with Cuba in this way. This will deal a devastating blow to those who prefer to make a quick dollar rather than take the morally superior stand of confronting the Cuban tyrant.

A post-Castro Cuba should be prosperous, but not at the expense of the freedoms of the Cuban people. The Cuban people must have the right to exercise their right to free expression, to vote, and to practice the religion of their choice.

A post-Castro Cuba must be marked by first of all, a pluralistic representative government which allows all views to be expressed and presented, thus allowing the Cuban people to freely choose their representatives.

We must remember that a free-market economy does not exist in a vacuum. That free-market system which should reign in Cuba must be founded on the principle of private property rights for all Cubans.

We must look forward to a Cuba where foreign investment is attracted not by the expectation of investors to make a quick dollar and exploit Cuban labor, but by the potential of the natural and human resources of the island and the strong desire for a better future for the people of that island.

Those investors who today venture into the island to purchase stolen and confiscated properties do not intend to maintain a lasting presence in Cuba. They only intend to stay on the island as long as they have Castro to allow them to exploit the Cuban people and deplete every national treasure on the island.

The United States should start preparing for a future Cuba, but one in which Castro is no longer in power and a truly transitional democratic government is in place.

The Helms-Burton bill also addresses this essential ingredient for the future prosperity of Cuba through title II of this legislation, which provides U.S. assistance to a free and independent Cuba. This section, drafted by our colleague, Bob Menendez, will develop a framework for future U.S. aid to the island.

However, this is only the beginning. U.S. investors should be provided incentives to invest in Cuba, and Cuba and the United States are bonded by their close geographical proximity and by the immigration of their people to both countries. These ties should be renovated after Castro and should form the basis for a lasting and peaceful economic partnership.

And I thank the chairman for holding this important hearing today.

[The prepared statement follows:]

Testimony by Congresswoman Ileana Ros-Lehtinen before the House Trade Subcommittee:

Thank you, Mr. Chairman. First I want to thank the Trade Subcommittee for providing me with the opportunity to testify during this visionary hearing which begins to examine the future relations between the United States and a free and democratic Cuba.

It is also a pleasure to be part of the same panel as my distinguished colleagues who have worked so hard to eliminate the dictatorship which has ruled the island with an iron fist for more than three decades.

Through most of this century, the United States was Cuba's major economic partner, participating in virtually every sector of the Cuban economy.

The United States was a major player in sectors such as tourism and sugar and in the service sectors of the economy of the Caribbean island.

Thanks much in part to this investment from the United States, as well as the laborious spirit and entrepreneurship of the Cuban people, the island of Cuba quickly became a center for trade in the Americas.

Its fertile land, vast tracts of tourist beaches and resorts, and its geographical location, led Cuba to become one of the most developed countries in the hemisphere.

Cuba not only enjoyed healthy economic growth, but also counted with a Constitution with one of the more progressive political, labor, and health laws in the Americas.

Little could stop the partnership of prosperity which inextricably linked, through geographical location and common work and economic philosophies, the ties within Cuba and the U.S.

Unfortunately , there was one repressive force which not only severed these ties, but destroyed the development which Cuba was making -- Castro-communism.

The advent of the cruel and tyrannical dictatorship of Fidel Castro led the way toward the inevitable destruction of the close political and economic ties between the two countries.

With the help of the Soviet Union, Castro destroyed the incentive for the Cuban people to work through the abolition of private property.

He illegally and immorally confiscated and indeed stole property from foreign citizens, many of them Americans, and of course, mostly from the Cuban people themselves.

After 36 years of this socialist experiment, there is no doubt in anybody's mind that the Castro revolution has been a complete and total disaster.

Yet Cuba, and its people, continue to suffer under the thumb of Castro and his repressive regime.

However, we must also look ahead toward a new dawn in Cuba when liberty and democracy once again flourish in the land of Marti.

Today, in the International Relations Committee we are poised to help expedite the coming of that dawn when we expect to approve in the full committee and send on to the House Floor, the Helms-Burton bill.

This legislation addresses the influx of foreign investment to the island of Cuba from investors who are

indifferent to the plight of the Cuban people.

The legislation would not permit these investors from conducting business in the US if they choose to commerce with Cuba.

This will deal a devastating blow to those who prefer to make a quick dollar rather than take the morally superior stand of confronting the Cuban tyrant.

Yet, there are those who are encouraging the US to lift sanctions so that American companies can imitate their foreign counterparts.

They do not understand that this is not the best future for Cuba.

A post-Castro Cuba should be prosperous but not at the expense of the freedoms of the Cuban people.

The Cuban people must have the rights to exercise their right to free expression, to vote, and to practice religion.

Cuba should not find a prosperity which might provide its people with the mere basics to live but denies them of the unalienable rights which the forefathers of America wrote were self-evident and were critical in the road to happiness.

A post-Castro Cuba must be marked by first of all a pluralist representative government which allows all views, from left to right, to be expressed and presented, thus allowing the Cuban people to freely choose their representatives.

We must remember that a free-market economy does not exist in a vacuum.

On the contrary, free markets are buttressed by strong and honest governmental institutions which provide the legal and societal framework for the practice of voluntary economic relations.

That free-market system which should reign in Cuba must be founded on the principle of private property rights for all Cubans.

Private property remains the single most important incentive for work and success.

As it has been proven by the failure of communism worldwide and the success of capitalism, private property is the key to exploit the full potential of a persons abilities and this shall continue in a free and democratic Cuba.

We must look forward toward a Cuba where foreign investment is attracted not by the expectations of investors to make a quick dollar and exploit Cuban labor, but by the potential of the natural and human resources of the island and the desire for a better future of the people of the island.

Those investors who today venture into the island to purchase stolen and confiscated properties do not intend to maintain a lasting presence in Cuba.

They only intend to stay on the island as long as they have Castro to allow them to exploit the Cuban people and deplete every national treasure of the island.

The United States should start preparing for a future Cuba but one in which Castro is no longer in power and a transitional democratic government is in place.

The Helms-Burton bill also addresses this essential ingredient for the future prosperity of Cuba through title II of the legislation, which provides US assistance to a free and independent Cuba.

This section, drafted by my colleague Bob Menendez, will develop a framework for future US aid to the island.

However, this is only the beginning.

United States investors should be provided incentives to invest in Cuba. Whether through tax incentives, from Cuba and from the US, or through the inherent potential of the island, the United States should once again play a key role in the future prosperity of the island.

Cuba and the US are inextricably bonded by their close geographical proximity and by the emigration of their peoples to both countries.

These ties should be renovated after Castro and should form the basis for a lasting peaceful economic partnership.

I thank this committee for taking the time to look into and promote these future economic ties.

I hope that we can soon meet again in this subcommittee discussing the new US-Cuba partnership in a free and democratic Cuba.

Once again, thank you Mr. Chairman for this opportunity.

Mr. SHAW. Thank you.

Our next witness also is a Cuban-born American citizen, who we certainly welcome to this committee, my colleague from Florida, Lincoln Diaz-Balart.

Lincoln.

STATEMENT OF HON. LINCOLN DIAZ-BALART, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. DIAZ-BALART. Thank you, Mr. Chairman.

I want to first commend you for your statement earlier today. I not only agree with it but think that it was extremely on point with regard to the need not only to know the recent history of Cuba and its relationship with the United States, but also the importance of thinking about the future.

One of the things that Castro implemented from the very beginning when he took power was one of his beliefs that he shared with the Nazis, the Nationalist Socialist regime in Germany.

As you know the Propaganda Minister in the Nationalist Socialist regime, Mr. Goebbels, would often state to the inner circle of Hitler and Ribbentrop and the others, he would say: Small lies are not effective, and they are easily countered, but extreme lies can be very effective in implementing the goals of national socialism.

Castro understood that theory well, and he began to implement it from the very beginning of his regime.

In 1960 when Castro addressed the General Assembly of the United Nations, he already—well, he called his statement, his speech, "The Case of Cuba is the Case of All Underdeveloped Countries." That is what Castro called his address to the General Assembly of the United Nations in 1960.

It is interesting that even at that stage, that early on in his dictatorship, he realized the importance of lying to the world and lying to the Cuban people about Cuban history and about the reality of Cuba before he had taken it over.

He, in that speech, labeled Cuba as an underdeveloped country, and in support of his evaluation he cited the following figures:

Unemployment rates in 1960 rivaling those, he said, existing during the Great Depression in the United States; lack of electricity and housing with sanitary facilities by almost 50 percent of the population; a 38 percent illiteracy rate, he said; high infant mortality and low life expectancy; and large foreign ownership of public services and industry.

That is how he described Cuba at the moment that he took it over.

It is interesting that even, for example, if we look at one industry, the sugar industry, the main industry of Cuba, whereas in 1939, 20 years before Castro took over, there were 118 sugar refineries owned by non-Cubans, and only 56 were owned by Cubans, by 1952, 113 sugar refineries were already Cuban-owned, and they had been, by the way, purchased. These were refineries that were purchased at market value from their owners by Cuban citizens. And only 48 sugar refineries by 1952 remained owned by foreigners.

So even with regard to the sugar industry, the lies that there was large foreign ownership of industry can be seen to be totally

obvious. And if you go down the line, whether it is on education and health and all the other myths that Castro from the very beginning tried to create, we see that he understood Goebbels' theory very, very well and began to implement it.

In 1958, the minimum agricultural salary of Cuba, which was $3 a day, was second in the Western Hemisphere only to the United States. The minimum industrial salary of $6 was second only to the United States. And interestingly enough with regard to, for example, the agricultural salary, Cuba—having a strong agricultural presence at the time, was seventh in the world, not only second in the hemisphere, but seventh in the world in 1958.

So this is important because, for example, between 1945 and 1951, the average increase in Cuba's per capita national income was 9 percent a year. And during the fifties, the average was 4.6 percent a year, which in the Western Hemisphere has been rivaled in the last generation only by Chile.

So it is important to know the history of Cuba to be able to realize that Castro has created a myth from the very beginning, as I have stated, that he took over an undeveloped economy; and that has served him in order to justify his destruction of the economy. And obviously there can be no doubts as to the depths to which the economy of Cuba has fallen.

And I want to remain brief, because there are many other speakers and I do not want to continue taking your time, Mr. Chairman and members, but I just want to end by saying the following:

There can be no doubt that Cuba, once it rids itself of the dictatorship and is able to—the Cuban people are able to live under the rule of law and in a system where their self-determination can be manifested in free and fair and periodic elections, there is no doubt that an extraordinary economic development will occur again.

Obviously it will have to commence from a point of destruction, which is extremely unfortunate. But I have no doubt that the Cuban people, being the industrious, hardworking, and very talented people that they are, will once again reconstruct their economy, and that there will be once again a close commercial relationship with the neighbor to the north, which existed before.

As you know, Mr. Chairman, the United States purchased almost half of the sugar production of Cuba before Castro at a preferential rate, which was really the envy of the world. No one has equaled that, the fact that more than 3 million tons a year were purchased by the United States at a preferential rate from one country, Cuba.

And Castro denounced that as one of the evils of the Cuban economy. I know that sounds inconceivable, but he actually denounced the fact that the United States would purchase over 3 million tons of sugar a year at a preferential rate and called it an evil and, of course, achieved the destruction of that reality as well.

So I am convinced that there will be a close relationship in the future, and I envision—obviously no one has a crystal ball—but I would envision that like, for example, in Europe there developed—we saw first the European Free Trade Association develop into the Common Market, develop into then the European Economic Community, and now, of course, the European Union—I would envision that it is very likely between Cuba and the United States, due to the historical affinity and the friendship between the Cuban and

American people that has always existed, that there will develop a close commercial relationship, and hopefully there can develop an economic community between the United States and a free, democratic, and independent Cuba that will be to the benefit of not only the reconstruction of Cuba, but also of the prosperity of the United States.

I think it will be a mutually beneficial economic relationship which will contribute to a reconstruction which I think—even though it will have to begin from a point, as I stated, of great destruction, unfortunately because of the destruction caused by Castro to his people—

I think that within a short period of time, we will see a reconstructed and prosperous Cuba with a Government serving its people democratically and with the rule of law.

Thank you, Mr. Chairman.

Mr. SHAW. Thank you, Lincoln. I appreciate your fine statement.

The next speaker will be Robert Menendez, another Cuban-Amercan, who continues to serve his country well as a Member from the State of New Jersey.

Bob.

STATEMENT OF HON. ROBERT MENENDEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. MENENDEZ. Thank you, Mr. Chairman, and to you and the ranking member and the other distinguished members of the subcommittee. I thank you for the invitation to come and testify today, and I welcome the opportunity to talk about Cuba-U.S. economic relationships in a post-Castro Cuba, hopefully in the very near future.

Are there opportunities for U.S. investors in the post-Castro Cuba? The answer to that is: Certainly. They will be found primarily in tourism, in mining, in agriculture, in construction and infrastructure development, and technology and environmental cleanup to mention a few of the areas.

But I think that we have to remember that when we look at this topic and those who are pressing to consider that today we lose opportunities, we need to create a certain framework.

Today Castro is in his 36th year in power. And let me suggest that one cannot begin to comprehend the possibility for a U.S.-Cuban economic relationship outside of a political context.

All Cuban economics may be reduced to a basically political calculus; that is: What economic policies can ensure that Cuba does the minimum economically, so that Fidel Castro can survive politically?

And let us be clear, Mr. Chairman. Cuba's economy is not on the same path toward growth as are other developing countries. The tiny economy Cuba does have is unlike others throughout the rest of Latin America and the Caribbean and the rest of the world. Its central objective is not obtaining competitively the prosperity or the well-being of a people; rather the entire economy is based on a purposeful decision to allow Fidel Castro to continue pursuing his failed experiment at government.

Ultimately it is an irrational economy, to say nothing about its lack of productivity. And the so-called reform process that you may

have heard about underway in Cuba is doomed to fail for one simple reason, if that is the course that it goes on without change to it. It does not involve the genuine participation of the Cuban people. Tragically, the Cuban people have no stake in their own economy. They are economic strangers in their own land.

If Cuba is to attract sustained investment, it will require a pluralistic democracy and a market economy. The Cuban Government at some point has to lift the lid off reform. The political dictatorship, which excludes or represses popular participation, is clearly not viable. And recent reforms to Cuba's external economic sector will not, in and of itself, lift Cuba out of its quandary.

The former Spanish Economic Minister, Carlos Solchaga, a member of the Spanish Socialist Party, in this respect at the request of Castro through Felipe Gonzalez, the Prime Minister of Spain, went to Cuba and did an analysis of Cuba's economy. And he said that the reforms enacted to date are insufficient and will be insufficient to lift Cuba out of its quandary.

Now this is someone who is sympathetic to the regime.

Such a system of government simply cannot be sustained internally. So the genesis of a new system of government in Cuba, therefore, is inevitable.

Yet Castro has basically rejected the very advice that he sought, Mr. Solchaga's blueprint for economic recovery, because ultimately it would mean democratization. And if Castro has made any changes, he has done so only out of necessity.

Only necessity forced him to reduce his sponsorship of revolution and terrorism abroad.

Only necessity forced him to downsize the third largest army in the Western Hemisphere.

Only necessity has led him to make deals with foreign investors in terms that are so exploitive they are shameful, so exploitive with respect to labor rights and environmental damage that they fly in the face of every pronouncement he has made in the past.

And most likely, only necessity will compel Castro to institute genuine reforms like those that Solchaga talked about beyond the cosmetic and exploitive reforms that we have seen to date.

Now let me just say that with respect to foreign investment, one must question the positive reports that we keep hearing about. To begin with, no one has hard data on the Cuban economy over the last 6 years. Cuba has not released any statistics at all since 1989.

But I would suggest that if we looked at the opportunities, they are quite limited in terms of returns on investment presently.

And what about the relationship of the Cuban people with the Cuban economy? What about investment opportunities for the Cuban people in their own land, as we have here?

Unfortunately there is no domestic investment in Castro's Cuba; there is no market; there is no purchasing power. And basically with the exception of a privileged few, the Cuban people still receive all, virtually all, of their goods in rations.

So I have much more, and I would ask the chairman if we could have our full statement in the record.

[At the time of printing, no statement was received:]

But I will close by saying simply that in thinking about this topic 2½ years ago when I first came to the Congress, I introduced a bill, "The Free and Independent Cuba Assistance Act."

It is as forward thinking as the committee is today in its viewing what is our role; what will be our relationship in a post-Castro Cuba?

It seeks to help the Cuban people in a transitioning economy, in a transitioning to democracy, as well as in a democratically elected government, and to forge ties with the Cuban people and with those governments in transition and ultimately a democratically elected government, so that, in fact, the United States will once again have the relationship which will be in the best interests of Americans as well as on behalf of the Cuban people.

And I urge you to look at that. It is also title II of the Cuban Liberty and Democracy Solidarity Act that Mr. Burton is sponsoring.

And last, to the business community, Mr. Chairman, I think our message should be clear. The highest yields—the highest yields—await for you in a post-Castro Cuba.

The greatest risks exist in Castro's Cuba today, as we have seen through expropriated properties, the lack of a legal system to enforce contracts, the type of a banking system that you would want to have, that you would, in fact, be able to participate fully in the type of economy that we would ultimately like to see, both for the Cuban people and for investment for our own companies.

And I appreciate the opportunity to be able to testify before you today.

Chairman CRANE [presiding]. Thank you, Congressman Menendez, and good luck in your committee work now.

Next, Mr. Deutsch.

STATEMENT OF HON. PETER DEUTSCH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. DEUTSCH. Thank you, Mr. Chairman, and I appreciate the opportunity to be with you this morning.

I have a relatively extensive statement that I would like to introduce in the record and just highlight several points in that statement.

[At the time of printing, no statement was received:]

Chairman CRANE. Without objection, so ordered.

Mr. DEUTSCH. Thank you.

As you probably are aware, my district is the district closest to Cuba. I represent the Florida Keys, including Key West. And when you are in Key West, Fla., you are actually 90 miles from Havana, Cuba and you are 110 miles from Miami. I live at the northern border of my district, which is over 200 miles from Key West.

Mr. Shaw obviously—also he and I share two of the three counties I represent—has a sense of the impact of what happens in Havana has on South Florida, not just in the Keys, but throughout Dade and Broward and Palm Beach Counties as well.

To give you a sense really of the interaction of the Cuban economy and the American economy pre-Castro, when you talk to oldtimers in Key West, Fla., they talk about the fact that when they were growing up, it was not unusual to go to physicians in Havana

rather than physicians in Miami, because it was easier to get to Havana than it was to Miami during that period of time.

I think what is important also for all Americans and obviously all Members of Congress to understand is that in pre-Castro Cuba, there was no immigration. There were, in fact, quotas that were allowed for Cubans to come to the United States during that period of time that were never met. That was a period of time where the economy really had a future and where there was full employment.

It is an economy with an abundance of natural resources, and economic opportunity that can clearly be a locomotive of an island in the Caribbean.

Yet it has not been. It is an economic basket case. It is a society right now which is—which really—there are press accounts of people killing domestic animals for food. It is a Third World economy at its worst, with all the attempts of Castro right now to change that.

And I think what is also important for all Members of Congress and the American public to understand is that we are talking about a dictatorship that our own government—the State Department consistently in reports describes as amongst the worst dictators in the world.

And with all the happy stories—and I know my colleague from California is going to describe some of his constituents who visited Cuba—they are not visiting all of Cuba; they are not talking to the dissidents who are in jail, who have been tortured, who have been maimed, who have been killed.

There are just consistent accounts in our own State Department's account, and I would urge my colleagues who believe that this is an idyllic island and believe this is the leader of a noble revolution to—do not listen to me; listen to Amnesty International, listen to our State Department, listen to other civil rights groups, speak to people.

I have had the opportunity to speak to scores of people who have left the island. And speak to them in your own words or through an interpreter to ask about the experiences that they are having, not just in Cuba in the hotel, but on a boat that they have left and they have risked their lives.

And I think that is in many ways the context that we need to be looking within.

And then once we sort of say that, I think we all have a sense of the last 15 years of world history, and how dictatorships have gone down. If we really—and I believe all members share Mr. Rangel's thoughts that our goals are the same for a free Cuba, a free Cuba both politically and economically.

And I think what we are forced to then do is say: How do we get there?

And there is a wide range of debate in terms of how we get there. And I guess that wide range of debate really can be boiled down to two different approaches.

And again, we can look at how dictatorships have fallen over the last 15 years. And the question that we then come up with: Do we want to tighten the noose that has consistently worked, particularly with levels of dictatorships similar to the Castro regime, not to give him more freedom to abuse his own people?

And in that approach, what we really are saying is that those allies of this country—like Canada, like Mexico, like Spain, who are probably the three largest trading partners now with Cuba—that we all have an interest in eliminating the 1 of 35 governments in the Western Hemisphere that remains a dictatorship. And that is an important—again an important fact that people should realize, that we have interests with our allies to change the dictatorship that way.

There is an alternative approach of trying to overwhelm with democracy. But what I would also urge, not just my colleagues, but really the administration, because we have an administration now which has a schizophrenic policy regarding Cuba—it says that it wants to both have an economic stranglehold approach and a free exchange approach at the same time.

And I think what is clear from the administration's perspective, that by doing both, they effectively are doing neither, and they are getting the worst of both worlds in that situation.

Again, I appreciate the Chairman's having this hearing, and I look forward to working with my colleagues in terms of achieving a goal that we all believe in.

Chairman CRANE. Thank you, Congressman Deutsch.

Congressman Farr.

Mr. RANGEL. Mr. Chairman, I wonder whether Congressman Deutsch would be able to stay with us for some questions?

Mr. DEUTSCH. I would be happy to.

Mr. RANGEL. Thank you. Thank you, Mr. Chairman.

Chairman CRANE. Congressman Farr.

STATEMENT OF HON. SAM FARR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. FARR. Thank you very much, Mr. Chairman. I appreciate this opportunity to speak before you on the U.S. economic and diplomatic embargo against Cuba.

I am not of Cuban descent, nor do I represent many Cuban-Amercans. I represent a district on the coast of California that has a lot of constituents that are very interested in Cuba; they have traveled there, visited, and have reported time and time again that the economic embargo has been devastating to the people of Cuba and unnecessary since the end of the cold war.

It both hurts U.S. business and the people of Cuba. And although you have heard today on this panel that it may be good politics for some Members of Congress, I think it is bad American trade policy.

A number of my constituents just recently returned from a trip to Cuba. They reported unprecedented signs of economic and social growth and activity—street vendors, artisan stalls, and other small businesses started by entrepreneurs that had appeared. New hotels for a growing tourism trade have been built on the Cuban beaches.

What they saw testifies to the fact that the embargo is keeping American businesses out of an increasingly lucrative and prosperous market.

Cuba has made unprecedented changes in their investment laws, permitting more foreign investment than ever before. As a result, while we sit here, we watch other countries; we watch Europe and Latin America, including Spain, England, France, Mexico, and now

Israel, who have taken advantage of a lucrative market and have begun investing in Cuba.

The numbers speak for themselves. Latin American countries, such as Mexico, Brazil, and Chile, have expanded their share of Cuban trade from 5 percent in 1989 to 40 percent last year. Caribbean nations have over $150 million in trade with Cuba. Cuban exports grew last year by 10 percent. And increasing numbers of tourists—from Italy, France, England, and elsewhere—have led to Cuban plans to build up to 27,000 additional hotel rooms to accommodate them. As a result, Cuba's economy has gradually begun to recover—0.7 percent increase in gross domestic product alone in 1994.

There are those who argue that we need to stop these countries from making such investments. Frankly, I am not sure how we could force other countries, most of them close trading partners with the United States, to change their own trade policies.

But more importantly, I believe that we need to become more engaged in Cuba, not less. Ending the economic embargo will allow U.S. companies to invest in Cuba and would greatly contribute to the well-being of the Cuban people.

Mr. Chairman, it is no longer traditional advocates of ending the embargo who are being heard. Indeed, more and more conservative voices are rising in opposition to the embargo. The economists called our policy toward Cuba "30 years of harm to American and Cuban interests alike." They pointed out that the embargo is not hurting Castro, but rather the victims of it are the Cuban people.

And just last month, the editor-in-chief of U.S. News & World Report wrote against the strengthening of the embargo, which would, he said, "reduce the incentive to create a new government in Cuba and increase the risk of more Cuban refugees fleeing to the United States."

I see no reason to punish children in Cuba and businesses in our own country to fight a war that has already ended. Unless we want to start another war, a trade war, with many of the nations that have invested in Cuba, we should avoid passing additional restrictions on trade with Cuba.

I urge the subcommittee to take a close look at the embargo and to take into consideration the effect of our policy on the politics of Cuba and the economy of our own country.

I commend the Chairman and the committee for holding this hearing, and I would be glad to answer any questions you may have.

Thank you, Congressman Farr.

Congressman McDermott.

STATEMENT OF HON. JIM McDERMOTT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I ask unanimous consent to put my whole speech in the record, and I will excerpt from it.

Chairman CRANE. Without objection, so ordered.

Mr. MCDERMOTT. Thank you.

I think it first needs to be said that I think this is the first time that the Ways and Means Committee has ever had a hearing on

trade in Cuba, and I think the Chairman is to be commended for his courage and leadership in that regard.

Mr. RANGEL. If the gentleman would yield——

Mr. MCDERMOTT. Yes.

Mr. RANGEL [continuing]. I did hold hearings the year before last on this subject.

Mr. MCDERMOTT. I missed it. I am sorry.

Mr. RANGEL. That was in the old Congress, though. [Laughter.]

Mr. MCDERMOTT. I know you have been here a long time, Charlie, but I did not know you had ever had a hearing on Cuba.

Although I realize that the focus of today's hearing is the economic opportunities in Cuba after Fidel Castro, I do not believe it is possible to address Cuba's future without some discussion of our present policy.

I personally am strongly in favor of ending the 32-year-old embargo on Cuba. I have cosponsored legislation introduced by Mr. Rangel which will enhance the relationship between the two countries by removing the unilateral trade restrictions imposed by the United States.

After 32 years, it should be obvious to everyone that the embargo has not worked. Castro's regime is solidly entrenched. The embargo's only achievement, I think, has been to impose unnecessary hardship on the Cuban people.

A recent Defense Department study done by Nestor Sanchez and Jay Mallon confirms this position, that Cuba is stable, without any likelihood of internal rebellion, that its military is extremely unlikely to oppose the leadership of Fidel Castro, and that the majority of the Cuban people and the military support the revolution.

Castro appears poised to survive in the near term despite assertions by conservatives in the United States that his control is ending. Mr. Sanchez, one of the report's editors, is a former CIA agent and Deputy Assistant Secretary of Defense in the Reagan administration. So this is somebody with a fairly solid background, who I think has prepared a very good study.

If the United States hopes to be able to exert any influence at all on post-Castro Cuba, we need to start liberalizing our trade restrictions now as the best way to promote change in Cuba and mutual respect between the United States and Cuba.

I believe further that the greater interaction between both the commercial and cultural sectors serves as the most effective strategy to influence change inside Cuba. This same strategy is slowly creating dramatic change in China, Russia, and even in Vietnam.

Cuba is a stable country, despite more than three decades of economic and political pressure by us. It has 11.1 million residents, a gross national product of $13.7 billion, and immediate proximity to our shores. It is a natural market for U.S. trade and investment.

Cuba's population is more productive, literate, educated, and motivated than the population of any other Caribbean nation. It has 16 major ports and 26 civilian airports of which 10 can handle international flights.

Cuba's ready work force and solid transportation infrastructure will be the basis for rapid economic growth.

Now the Cuban embargo is costing Americans in both money and lost job opportunities. A 1992 study by the Cuban Studies Program

at Johns Hopkins University describes in detail the cost of the embargo on American businesses. And I will give one example.

The opening of Cuba to U.S. tourism would have a dramatic impact on South Florida's cruise industry. It is estimated that the number of cruise passengers taking advantage of Cuba and its ports would reach more than $2.4 million annually within 10 years of lifting the embargo.

In 1995, Cuba expects to receive almost 1 million tourists producing in excess of $1 billion in gross revenues.

Now since their unprecedented economic decline in the summer of 1993, Cuba has undertaken a series of reforms designed to improve the rapidly deteriorating economic situation. Castro has begun to replace the Cuban economy, reshape it, and to make it more inviting for foreign investment.

In 1995, they will enact a new foreign investment law, which it is hoped will attract more overseas capital. The legislation will allow 100 percent foreign ownership and will simplify modern foreign investment in the country and eliminate many of the paperwork bottlenecks. This is a very serious step toward a market economy.

Currently Cuba has approximately 4,000 foreign companies representing 80 countries. There are more than 200 joint ventures with a value of over $1 billion operating in Cuba. That is a 1,000 percent increase from the 20 joint ventures in 1991.

Cuba has increased opportunity in self-employment, in agriculture, handicrafts, and merchandising. Over 200,000 Cubans are operating in the dollar-denominated segment of the economy. That is like the segment in China which is the entrepreneurial part.

However, some of the opportunities I have described are being lost to American businesses. The Castro government is busy making deals and signing contracts with companies and corporations from Europe, Asia, and Canada. By keeping American businesses out of Cuba, the prime business opportunities are going to our competitors. For example, the European, Caribbean, and Latin American tourism industry is currently dividing up their beachfront. The U.S. oil industry can only watch as European and Latin American firms explore along the Cuban coast.

The Atlantic Council has recently estimated that if the United States ended the embargo on Cuba, U.S. exports to Cuba would grow by $2 billion a year, resulting in the creation of 30,000 jobs. These are jobs that this country desperately needs, and it makes no sense to continue an embargo that cannot achieve its objective.

For that reason, Mr. Chairman, I am glad that you have conducted this hearing, because I think it is an economic question, as well as a political and a human question. And I think people have to begin to look at that and say to themselves: Has the embargo worked?

And the answer is a resounding no. And if something does not work in America, usually we say: Well, let us stop that, and let us do something else. I think we ought to do that with respect to Cuba.

Thank you.

[The prepared statement follows:]

News from Congressman

Jim McDermott

7TH DISTRICT • WASHINGTON

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STATEMENT BY CONGRESSMAN JIM MCDERMOTT BEFORE THE
WAYS AND MEANS, TRADE SUBCOMMITTEE HEARING ON
THE RELATIONSHIP BETWEEN THE UNITED STATES AND CUBA AFTER CASTRO
FRIDAY, JUNE 30, 1995, 10:00 AM
1100 LONGWORTH

Mr. Chairman:

Thank you for the opportunity to testify before you today. Although I realize that the focus of today's hearing is on economic opportunities in Cuba after Fidel Castro, I do not believe it is possible to address Cuba's future without some discussion of current U.S. policy towards Cuba.

I am strongly in favor of ending the 32 year-old United States embargo on Cuba. I have cosponsored legislation, H.R. 833, introduced by the Trade Subcommittee's Ranking Member Rep. Charles B. Rangel (D-NY), that will enhance the relationship between the two countries by removing unilateral trade restrictions imposed by the U.S.. After thirty-two years it should be obvious to everyone that the embargo has not worked -- Castro's regime is solidly entrenched. The embargo's only achievement has been to impose unnecessary hardship on the Cuban people. A recent Defense Department study by Nestor Sanchez and Jay Mallin confirms my position that Cuba is stable with little likelihood of internal rebellion; that its military is extremely unlikely to oppose the leadership of Fidel Castro; and that the majority of the Cuban people and the military support the Revolution. Castro appears poised to survive in the near term, despite assertions by conservatives in the U.S. that his control is eroding. Mr. Sanchez, one of the report's authors, is a former Central Intelligence Agency official and deputy assistant secretary of defense in the Reagan Administration.

If the U.S. hopes to be able to exert any influence at all on a post-Castro Cuba, we need to start liberalizing our trade restrictions now as the best way to promote change in Cuba and mutual respect between the U.S. and Cuba. I strongly believe that greater interaction through both commercial and cultural exchange serves as the most effective strategy to influence change inside Cuba. This same strategy is slowly creating dramatic change in China, Russia, and soon in Vietnam.

Cuba is a stable country despite more than three decades of economic and political pressure on Castro by the U.S. government. With 11.1 million residents, a gross national product of $13.7 billion, and immediate proximity to U.S. shores, Cuba is a natural market for U.S. trade and investment. Cuba's population is more productive, literate, educated and motivated than the population of any other Caribbean nation. Cuba also has 16 major ports and 26 civilian airports, of which ten can handle international flights. Cuba's ready workforce and solid transportation infrastructure will be the basis of Cuba's potential for rapid economic growth.

The Cuban embargo is costing Americans in both money and lost job opportunities. A 1992 study by the Cuban Studies Program at Johns Hopkins University describes in detail the cost of the embargo on American businesses.

* U.S. sugar refineries that import raw sugar from Far Eastern suppliers could save an estimated $6.5 million dollars a year by importing Cuban sugar.

* The opening of Cuba to U.S. tourism would have a dramatic impact on South Florida's cruise industry. It is estimated that the number of cruise passengers taking advantage of Cuba and its ports will reach more than 2.4 million annually within 10 years of ending the embargo.

* In 1995, Cuba expects to receive almost a million tourists producing in excess of $1 billion in gross revenues. As more world-class hotels open, Cuba can be expected to capture an increasingly larger share of the Caribbean tourist market. Unfortunately, because of the embargo, U.S. hotel chains are not able to take advantage of Cuba's tourist potential.

* By purchasing Cuban citrus, the United States could save $34 million per year, or $150 per ton on citrus imports.

* U.S. importers could save money by importing Cuban seafood, coffee, tobacco, rum, honey, and marble.

* The United States could capture a large portion of Cuba's textile imports. It is estimated that the United States could sell Cuba 20,000 tons of cotton 5,000 tons of polyester and rayon fibers and over $1 million dollars worth of thread each year.

* U.S. grain exporters could capture most of the $400 million a year Cuban grain market.

* U.S. oil industries could explore the oil rich Cuban coastline.

Canadian imports from Cuba in 1993 amounted to $140 million, mostly sugar and nickel. That year Cuba bought $77 million worth of Canadian goods. About 30 Canadian companies have joint venture agreements with Cuban counterparts, and Canadians are Cuba's principal source of English-speaking tourists -- some 130,000 Canadians flock to beach resorts east of Havana every year.

These are just a few of the lost opportunities for American businesses in Cuba. And, unfortunately, this is just the beginning -- there will be many more lost trade and investment opportunities for U.S. companies if we continue to believe that we must maintain the embargo as long as Castro is in power.

Since Cuba's unprecedented economic decline in the summer of 1993, Cuba has undertaken a series of reforms designed to improve the rapidly deteriorating economic situation. Castro has begun to reshape the Cuban economy to make it more inviting for foreign business investment by bringing Cuba's business practices more in-line with those of other Caribbean countries.

In 1995, Cuba will enact a new foreign investment law it hopes will attract more overseas capital. The legislation will allow 100% foreign ownership and will simplify and modernize foreign investment procedures and eliminate many of the bottlenecks and roadblocks that potential foreign investors have complained about in the past. This is a significant step toward a more market-oriented economy.

Cuba currently has commercial relationships with approximately 4,000 foreign companies representing more than 80 countries. There are more than 200 joint ventures, with a value of over $1 billion dollars, operating in Cuba. This is a 1000 percent increase from the 20 joint ventures in 1991.

Cuba has created opportunities for self employment in agriculture, handicrafts and merchandizing. Over 200,000 Cubans freely operate in this dollar denominated sector and the number is growing.

However, some of the opportunities that I have described are vanishing for American businesses. The Castro government is busy making deals and signing contracts with companies and corporations from Europe and Asia and the rest of the world. By keeping American businesses out of Cuba, the prime business opportunities are going to our competitors.

For example, the European, Caribbean and Latin American tourism industry is currently dividing up Cuba's beautiful beachfront property. The U.S. oil industry can only watch as European and Latin American firms explore for oil off Cuba's coasts.

The Atlantic Council has recently estimated that if the U.S. ended the embargo on Cuba, U.S. exports to Cuba would grow by $2 billion dollars per year resulting in the creation of more than 30,000 jobs in the U.S.. These are jobs that this country desperately needs and it makes no sense to continue an embargo that cannot achieve its objective. If we lift the embargo now, our economic and political relationship with post-Castro Cuba will be bright and productive for both the U.S. and Cuba.

Chairman CRANE. Thank you, Congressman McDermott, and the first to question our witnesses is our distinguished ranking minority member, Mr. Rangel.

Mr. RANGEL. Thank you. I am going to try to be brief because we have a lot of witnesses, and we have to get out of here.

This is a very emotional subject. I want to thank you for having this hearing. I hope every committee could have hearings. I think we ought to ask the questions and respect each other's opinion. And that is why I am glad Congressman Deutsch said—you consented to remain.

This hearing is trade with Cuba after Castro.

What do you perceive the new government will be after Castro? Who would be the person now? Since I know we have to have some plan, America is thinking about having these hearings in the future, who would we be dealing with? Who are the possible candidates for a new democratic Cuba?

Mr. DEUTSCH. Are you directing that to me?

Mr. RANGEL. Yes.

Mr. DEUTSCH. First off, the reality is, Castro is not at his deathbed. I mean, you know, lightning can strike, but it could have struck yesterday; it could strike today, but, I mean, he is not at his deathbed today.

I think the reality of the country is—for me to predict the dynamics of who is going to be elected, who are the candidates in the Cuban domestic election, a Presidential election, a legislative election, I just think is——

Mr. RANGEL. I am assuming—I am assuming that this embargo and the Helms embargo and all of this thing is going to put some pressure on, that something happens.

Now if you and I want something to happen to get rid of Castro's Cuba, we have got to have a game plan.

Mr. DEUTSCH. Well, let me——

Mr. RANGEL. Do you think there is going to be a revolution?

Mr. DEUTSCH. Let me say that there is a game plan, that I have been supportive of the Menendez bill, which I am sure you are aware of, which really, in a sense, sets up incentives that the Cuban people are aware of, that the Cuban Government is aware of, that Cuban military officials are aware of, that essentially says that this country is going to do a Marshall plan or a Marshall-type plan in a post-Castro Cuba, that we have—that that legislation is out there, that you, I am sure again, have reviewed. We talk——

Mr. RANGEL. Now look, it is the law. I do not care what theory you have got. My theory is, open up the doors, exchange students, get businesspeople over there, get those reporters over there to find out what this rascal is really doing with people, have an exchange. Let their students see our students, our students see their students. I really think like even in high crime areas, we say: Get the people in the street, and you will keep the criminals indoors.

I think let the sunshine continue to be in Cuba, and let the strength of capitalism work its will.

Obviously you think differently. I am trying to think like you. Give me the scenario.

Some people tell me if there is a revolution or he steps down, that the brother, who is really not a very pleasant person and

would make Castro look good, would take over. So I know we are not going to accept that.

Some people say there are some people in Florida, that they have already decided who is going to run for office. I have said: I do not believe that; these people are not thinking about leaving Miami.

They say that, well, the people are going to get fed up with this, and they are going to revolt. And I said: My God, are the people that are on these rafts the people who are going to lead the revolt?

I looked at the people in Cuba, and we do not even give them medicine or food or sell it to them. And then I looked at the army, and, my God, they are well fed; they are well trained. I said: We cannot have a revolution in Cuba.

They said: Why not? I said: Because the easiest thing to do is to get on the raft and get to Miami rather than to fight these guys that have been all over the world without invitation, fighting and killing people.

So I want to know your scenario, because there are any number of businesspeople waiting for us to get our act together, either overthrow him, invade there, set up a new government, you know.

And, of course, our friends—we just reached an agreement with Japan. We just signed the North American Free Trade Agreement. We have just bought into GATT. And I assume you support the Helms-Burton bill.

Mr. DEUTSCH. I do.

Mr. RANGEL. And so we are telling all these people, especially the Japanese, that if you dare trade, after we tell you not to trade with Cuba, we are going to prohibit any goods coming into our country from you. Your executives, shareholders, and families who do business cannot even get a visa to come here, and everyone can sue you for taking Cuban-Amercans' property.

I mean, this is heavy stuff. Having said that, assuming it works, my chairman wants to know how we can get an economic foothold in Cuba.

Who would we be talking with, if any of this stuff works?

Mr. DEUTSCH. Again, we have a history of dictatorships over the last 15 years that have gone to democracies. It has worked. It has worked in——

Mr. RANGEL. Well, we have always had our whole CIA——

Mr. DEUTSCH. No, no. But in Eastern Europe, I mean, we have had scores of countries that have changed their fundamental government over—that have been dictatorships over a 30-year period.

Mr. RANGEL. But we have had candidates, sometimes overtly, sometimes covertly. We have always had candidates.

Mr. DEUTSCH. Mr. Rangel, with all due respect, I mean, I have no candidate. I do not believe the U.S. Government has a candidate. I am sure there are people both in Cuba and I would not doubt in Miami that have visions of being elected in a post-Castro Cuba.

But I think we have experience over the last 15 years that countries do change the form of their government.

And I can say it in another way. I mean, you know, whether through peaceful or whether through violent means.

And you talk about the military. I mean, there are consistent high-level military people who have defected. I mean, MiG jets

have landed in my district at Boca Chica right outside of Key West on more than one occasion. And I can tell you about those MiG jets, and I have talked to the mechanics who have looked at the jets after they have landed, and they have told me about the low maintenance. And when they talk to the pilots about it, that they were not burning jet fuel because they could not afford jet fuel.

This is an economy that even at the highest levels in terms of the planes that they are sending, their highest level planes, have economic problems.

And the idyllic image, you know, that you are portraying and that Mr. Farr portrayed—and I think to some extent I really take strong exception to what my colleague from Washington, Mr. McDermott talked about—is that the embargo really is only in effect for 3 years.

I mean, the Torricelli bill, which is really the embargo, was passed in 1992. And it is not—that is not, by my calculation, 32 years.

We have seen the effect. And then also, I guess it is just wishful thinking in the other way; a fundamental change occurred with the demise of the former Soviet Union. That really was the economic linchpin of Cuba's success.

This year—not last year—this year is the worst production of sugar in the last 15 years in Cuba. If the economy is doing so great, by their own accounts in terms of the actual production of sugar—there are all these entrepreneur farmers that got the spirit of capitalism—why is the sugar production the worst in the last 15 years?

And we do have a sense. It is not just the CIA who is giving us accounts. There is nonstop service from Miami to Havana almost every day. And there is travel that goes on. And when there are press accounts, and people are leaving the shores of Havana, there were—there were television cameras there.

And again, in terms of recent history, I mean, you know, Castro is a master chess player in terms of letting out the plug.

I think—I agree with you that our government—really the U.S. Government, the Clinton administration, really probably lost an opportunity in how they dealt with the most recent rash of Cuban emigrés, because the public image of tens of thousands of people publicly demonstrating in a dictatorship that occurred in the port of Havana, you know, is unprecedented. I mean, it is really unprecedented in that type of government.

So to say that there is not a sense in the country of an opportunity for change is not looking at the country.

And I go back to tell you that when we look at 15 or 20 countries over the last 15 years that have changed their fundamental type government from a dictatorship to a democracy, they have changed different ways. Some of them have changed by bullets; some have changed by ballots and by international assistance in a variety of ways.

And I am not—I cannot predict to you how the Cuban Government is going to change.

Mr. RANGEL. OK.

Mr. DEUTSCH. But I can tell you that we do have a way—that in recent history the way governments have changed.

Mr. RANGEL. Thank you.

Mr. DEUTSCH. And I say to you that your approach is a potential approach, but I do not believe it is the right approach.

And I think what I would also clearly say, that from an administration standpoint—I mean, I said it during my statement, but I think members really need to hear it maybe more than once, is if you look at what the administration is doing, they are not doing either.

Mr. RANGEL. Thank you.

Mr. DEUTSCH. They are absolutely not doing either. And by not doing either, they get the worst possible results.

Mr. RANGEL. Thank you.

Chairman CRANE. The gentleman's time has expired.

Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I will be brief.

I just want to make a couple of comments and a couple of observations from the testimony that we heard.

I think, Mr. McDermott, I agree with you, and you are absolutely correct, in talking about the resourcefulness of the Cuban people. They have been extremely successful in our country, particularly down in South Florida. And Cuba was certainly head and shoulders ahead of the rest of the Caribbean before Castro took power.

The question is to whether or not our economic embargo and the policy of the last 30-plus years has been successful. We could certainly debate.

But I would submit that without assistance, the very overwhelmingly generous assistance of the Soviet Union in keeping Castro propped up all of these years, that he would have collapsed many, many years ago. And I think maybe we underestimated the resolve of the Soviets in recognizing the military importance of Cuba and their keeping Castro in power. Perhaps there was a miscalculation there.

But the economic—I think the basic economic policy of this country was correct.

Now that the Cubans no longer have the Soviets to prop them up, I think that it would be a very bad mistake to abandon that policy and to have a shift in the U.S. policy.

It may be a few years or even a few months before the whole economy of Cuba collapses to the extent that Castro no longer can survive.

Would we undergo the same policy, knowing that it was going to be 30-plus years before we brought down that oppressive regime?

I do not know the answer to that. But since this has been our policy, I think now is the time to stick with it, because I think that it is going to achieve its objective of bringing democracy to the island nation of Cuba.

Mr. MCDERMOTT. If I may respond?

Mr. SHAW. Yes, please.

Mr. MCDERMOTT. I think that we agree that it survived on the backs of the Soviet Union for many years.

The argument that I would make is that the time when they were really vulnerable was when the Soviet Union came down.

As Mr. Deutsch has suggested, all across the world, when the Berlin Wall fell down in 1989 in December, opportunities opened up everywhere for us to make inroads. And we did, and things fell.

I mean, you look at Poland, or you look at Czechoslovakia, or you look at all—and we are in Vietnam now—you know, of these issues.

But the one place that we have maintained our—what I would say "intransigent position" has been with respect to Cuba. And I would question your assertion that they are going to come down. I mean, that really is the nub of the question here. If we hang on a little longer, will they finally collapse?

What you see when you look at Cuba today is that Fidel Castro is not stupid. He is making rapid judgments about realigning himself with the rest of the world, changing, allowing foreign ownership to come in, 100 percent foreign ownership. They are making deals with everybody else in the world.

And unless—and I think unless we are able to pull off what we did in South Africa, where we got the entire world to put pressure on South Africa, an embargo is ultimately not going to work.

Now obviously we can—that is the real nub of the debate here. I think that we have plenty of examples around the world where embargoes did not work. When we put an embargo on Russian wheat, the only people that suffered out of that were the farmers in Washington State who could not export to Russia. In fact, they went to Argentina and Australia and got their wheat.

Mr. SHAW. Let me comment, because my time is about out. The question is what has happened in the former Soviet Union and those nations and the nations that were behind the Iron Curtain upon the collapse of communism in Europe. That is quite different than Vietnam and what has happened in Asia, because the parallel should really come from Europe.

What we saw there was democracy flourishing, people reaching out for democracy and the countries reaching out for democracy. It was a peaceful revolution.

That has not happened in Cuba. That is not what Castro is talking about. Castro has not talked about free elections. We obviously would much rather see a very peaceful transfer of power to a democratically elected government in Cuba—that has got to be our objective.

While Castro has reached out and tried to get investors from around the world into Cuba, he has not reached out to his own people and offered them democracy. That is the big difference between the other satellites of the former Soviet Union and in Cuba, and that is enough of a reason for us to hold onto our existing policy.

I thank you. We have an honest disagreement, but we certainly want the same objectives.

Thank you.

Chairman CRANE. Thank you.

Mr. Coyne.

Mr. COYNE. I have no questions.

Chairman CRANE. Mr. Hancock is not with us.

Mr. Ramstad.

Mr. RAMSTAD. My questions have already been responded to, Mr. Chairman. Thank you.

Chairman CRANE. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

I would like to direct my question to Mr. Deutsch.

You brought up the issue of the Soviet Union underwriting the economy, and you mentioned, I think, oil. Could we talk about that specifically for a second? Did you——

Mr. DEUTSCH. I think Mr. McDermott mentioned oil exploration.

Mr. NEAL. Could we talk about that?

Mr. MCDERMOTT. Well, certainly the Soviet Union was the main source of oil for the Cubans, the way that they got the money to get oil.

Mr. NEAL. Now it was literally a gift rather than a subsidy, right?

Mr. MCDERMOTT. Yes, yes.

Mr. NEAL. They subsidized their purchase of sugar. I mean, it was a whole sugar/oil kind of economy. Oil was essentially a gift to the Cubans to keep their economy running.

So in your comments, you suggested that Castro is prepared to undertake structural reforms in the Cuban economy that will allow not only for private ownership, but also lead to democratization down the road?

Mr. MCDERMOTT. That is my view. And, in fact, one of the things that has happened along the coast of Cuba is that countries are now looking at where we could drill, what are the potentials of drilling wells. And the rest of the world is looking at it also. But American exploration, oil exploration, cannot go on, because our government says our people cannot go do it.

But Cuba is reaching out to everybody else and saying: Come have a look and see where we might be able to; because they are looking for a source of oil and looking for a way.

And I think that getting in—our getting into China, the original getting into China, when Mr. Nixon opened up China, the process has gone much more rapidly, because the businesspeople were there, and the students were there, and the press was there. And the same, I think, will happen in Cuba.

Mr. NEAL. Well, I am delighted to hear you making these capitalist arguments. But let me go beyond that for a second, if I can.

Some years ago, I had a chance with a delegation to visit East Germany at the time that the wall came down.

The contrast in living standards between the East Germans, who the Americans purported to be the stars of the Soviet empire—the contrast of how they lived as opposed to how the West—was day and night. I think that in some circles we have been sold a bad bill in the sense that we have been told that the Cubans were the stars of the Western Hemisphere.

However, the truth is that without a huge subsidy from the Soviet Union, the Cuban economy probably would have collapsed a long time ago.

As you point out, Castro was fairly cunning in the manner in which he governs, or he certainly would not have survived for more than three decades.

But are you telling us today that you believe this fledgling democratization in the end will bring about the end of Fidel Castro?

Mr. MCDERMOTT. I do not know that I used the phrase "fledgling democratization." I would say "fledgling capitalist movement," be-

cause they are essentially allowing foreign ownership, whereas before it was all State ownership. They are allowing companies to come in and do things of that sort, entrepreneurial kinds of things.

You can also see the entrepreneurial kinds of things in the city. So there are—it is beginning to emerge.

The first time I went to China in 1977, it was the year after Mao died. There was no entrepreneurial stuff. You would occasionally see somebody selling cigarettes or pieces of cloth on the street, and as soon as you tried to take a picture, they would wrap it up and run away because they were afraid.

The next time I went back to China in 1982, it was everywhere. And if you go today to China, you can see the progression of changes.

You are seeing the very first seeds coming up out of the ground in Cuba, because they are going down, and they have to make changes, and Castro can see it and is making these kinds of changes.

Mr. NEAL. Mr. Deutsch, you are saying essentially that you believe that by tightening the noose, it will bring about those changes?

Mr. DEUTSCH. Well, I think we also are talking about—I think there is an experiment going on in Cuba and in China, that can you have this sort of quasi-capitalism without any freedom?

I mean, you know, yes, there has been a sort of an economic entrepreneurial shift in China at a small scale. But you also still have slave labor in China; you also still have child labor, you know, at very young ages in China. I mean, China is not the paradigm of freedom and democracy.

And I think again from my perspective in world history, there has not been a country that has been able to have this sort of capitalism/repressivism at the same time. And there is still torture. And Tiananmen Square still took place in the period that Mr. McDermott talked about.

And again, the level of catastrophe in the Castro economy is real. And I think Mr. Shaw really spoke to that. And again, the evidence, I think, is clear at this point in time, and there are press accounts, as I described, of people, you know, eating domestic animals just to survive, food.

And what I think is interesting—again, this is—you know, this is something we should all know, Castro legalized the possession of dollars. In this sort of market economy that Mr. McDermott is talking about, the old American greenback can legally be held in Cuba and can be traded and can be paid for in goods in Cuba today. I mean, those transactions that he is talking about and street vendors, you can pay in dollars and not be arrested, and it is legal.

I mean, what an admission of the catastrophe, of the utter failure of the 30 years of the dictatorship. I mean, just the acknowledgment that it does not work.

And I think what this—what our country—what this Congress really needs to decide—and again, I think the administration really has had this problem—I think all of us share the same goal, I mean, and Mr. Rangel and I, I think, absolutely share the exact same goal.

But the question is how to get there. And there really is this fundamental choice. It is a fundamental choice of saying: Let us open everything up completely, and let us just try to, you know, throw them—you know, throw them into an American economy.

And I guess what I would say is, hey, you know, that does not only work. And there is this problem, too, that that does not deal with the aspects of political freedom. It deals with this: Yeah, an American company can go in there, and in a society that does not have any legal system in terms of protecting property rights and contracts or other, and we do have American corporations that function in environments like that, or do we want to see a fundamental change?

And I think again Mr. McDermott pointed out the case of South Africa, where the conditions in South Africa before the embargo that worked, the prospect of change was much, much, much less likely than what occurred—than what exists in Cuba today.

And I guess what I really feel is, you know, when we are loaning the Mexican Government billions of dollars, as part of that negotiation, we ought to be talking to them about, hey, you know, let us help bring change to the Castro dictatorship.

And I think that there is a path there that we have not really done.

Mr. NEAL. I will just close on this note, Mr. Chairman, if I can, just for 1 second.

And, thank you, Bob.

Much of the objections from successive administrations to Castro and to Cuba largely came from the notion over a number of years that he was exporting revolution.

Mr. DEUTSCH. Right.

Mr. NEAL. That he was using Cuba as a base for South America and for the other nations in the Caribbean. I think we can all safely assume today that that threat has not receded, that it is over.

But one of the things I think it is important to point out to viewers and to the public is that this is one of those difficult issues in the sense that there is some truth to what both sides are saying here.

And the question for us, as we begin this national conversation about how best to bring Cuba back into the role of a more civilized community, I guess, is to try to convince them that democracy and capitalism and free markets, and at the same time how to hasten Castro's demise is also something that I think ought to be on the front burner of the American agenda.

Thank you, Mr. Chairman

Chairman CRANE. Thank you.

Are there any further questions on our side of the aisle? Mr. Zimmer. Ms. Dunn.

[No response.]

Chairman CRANE. Then I thank our witnesses for their testimony, and I will now invite Edward Casey, Deputy Assistant Secretary for South America from the State Department to be our next witness.

You may proceed at once, Mr. Casey.

STATEMENT OF EDWARD A. CASEY, DEPUTY ASSISTANT SECRETARY FOR SOUTH AMERICA, BUREAU OF INTER-AMERICAN AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. CASEY. Thank you, Mr. Chairman.

First, I would like to thank you for the opportunity to share with this committee the administration's view of Cuba's role in the process of economic integration in our hemisphere and to endorse the view of all the preceding members about the value of this particular hearing.

Cuba is a country with great economic potential, and unlocking that potential would have tremendous and lasting benefits for Americans as well as Cubans. Cubans on the island, like those in the United States, have demonstrated their talent and energy in countless ways.

The island of Cuba itself is endowed with valuable natural resources including fertile agricultural land, rich mineral deposits, oil fields, excellent deep water ports, and beautiful tourist attractions.

In spite of those sparkling possibilities, however, Cuba's economy is currently not just limping; it is crawling along. While some reforms have been implemented, they have been carefully limited to preserve the regime's control over individuals' livelihoods. The Cuban Government has so far sought to avoid more meaningful reform by aggressively courting foreign investment.

While the regime has claimed $1.5 billion in such investment and has alluded to U.S. businessmen making secret visits to Havana, the fact remains that most investors remain leery of Cuba's centralized and arbitrary investment approval process, the regime's still pervasive involvement in the economy, and the risk of political instability.

These and other factors have meant that investment to date in Cuba has been limited to relatively few sectors, particularly tourism, and it has largely been structured to provide rapid return on investment and ease of exit, if that should prove necessary.

There is no question that when change finally comes in Cuba, and U.S. businesses move in, there will be a wealth of opportunities for them. The U.S. proximity to Cuba, Cubans' continuing affinity for American products, and the strong cultural and historical ties that bind our two countries will mean that U.S. commercial involvement in Cuba is destined to be deep and beneficial to both Cubans and Americans.

The normalization of our trade relationship could proceed along three lines.

First, both Cuba and the United States are members of GATT and WTO. We would thus be able to provide a democratic Cuba with MFN, most-favored-nation, access to our market. American businessmen could compete in Cuba on an equal footing with other countries.

Second, a democratic Cuba would be welcome to participate in hemispheric efforts to build a free trade area in the Americas.

Hemispheric trade ministers are meeting today in Denver to take the first concrete steps toward the goal of completing an FTAA by 2005. The FTAA will provide opportunities for smaller economies like Cuba's to enhance their economic growth and development. Cuba cannot be welcomed into this family, however, until it has

embraced the same democratic and free market principles that unite the rest of its members.

Third, the United States could extend trade benefits to Cuba, equivalent to those of other countries of the Caribbean Basin, once Cuba meets the same requirements. This would include duty-free treatment under the Caribbean Basin Economic Recovery Act and the NAFTA parity legislation which you, Mr. Chairman, are sponsoring.

While the resurrection and reintegration of the Cuban economy will have immediate benefits for both Cubans and Americans, particularly Americans in Florida and other Southern States, there will be difficult obstacles to overcome.

Among these will be deteriorated infrastructure on the island, the Cuban people's lack of recent experience with free markets, the lack of institutions to support a free market economy, and perhaps thorniest of all, the resolution of property claims.

There are currently almost 6 billion dollars' worth of certified U.S. property claims, including the interest value over time. Cuba will face many more uncertified claims held by Cuban-Americans who have become citizens since their property was confiscated by the Cuban Government and still more claims from Cubans still on the island.

The U.S. Government will strongly encourage transition and a democratic Cuban Government to resolve all property claims promptly and appropriately.

The United States will strongly support the creation of a mechanism under Cuban or international law to do so. We will encourage restitution of property in cases where that would be appropriate.

The United States may also pursue a government-to-government settlement agreement. We cannot predict what form the solution to this problem will take now, but we are confident that a solution will be found.

Early resolution of claims will be essential not only for the sake of claimants, but also to firmly establish property rights for future Cuban and foreign investors to clear obstacles to privatization and heal old wounds in Cuban society.

It is important for us to begin planning now how the U.S. Government, as well as other governments and institutions could most effectively support a future transition to a democratic government in Cuba. Strong U.S. support would be crucial during a transition to help meet humanitarian needs and to assist in building democratic and free-market institutions.

Early involvement by the international financial institutions in Cuba, once a democratic transition has begun, will also be essential to help stabilize the Cuban economy and provide incentives for the new government to undertake difficult, but necessary, economic reforms.

Perhaps the most important U.S. contribution to the rebuilding of Cuba, however, would be made by our private sector. U.S. business will be extremely competitive in nearly all sectors in Cuba, including construction, repair and expansion of physical infrastructure, agriculture, mining, oil extraction, financial services, telecommunications, transportation, and tourism. The island will also

be an extremely attractive location for U.S. investors in light industry manufacturing.

The opportunities will be there, and I believe we can all be confident that American business will take full advantage of them.

Mr. Chairman, thank you again for this opportunity to reaffirm the administration's commitment to expanding our economic links in the Americas and our fervent desire to do all we can to help a democratic Cuba rejoin our hemispheric family.

Thank you.

[The prepared statement follows:]

TESTIMONY OF EDWARD A. CASEY
DEPUTY ASSISTANT SECRETARY
BUREAU OF INTER-AMERICAN AFFAIRS
DEPARTMENT OF STATE
BEFORE
THE HOUSE WAYS AND MEANS TRADE SUBCOMMITTEE
JUNE 30, 1995

I would like to thank you, Mr. Chairman, for the opportunity to share with this committee the Administration's view of Cuba's future role in the process of economic integration of our hemisphere. It is particularly appropriate that while economic and trade ministers from all over the Americas are meeting this week in Denver to plan that process -- a process that will unquestionably advance the United States' long-term economic interests -- we take time to discuss here the missing link in hemispheric solidarity: Cuba.

Mr. Chairman, Cuba is a country with great economic potential, and unlocking that potential would have tremendous and lasting benefits for Americans as well as Cubans. Cubans on the island, like those in the United States, have demonstrated their talent and energy in countless ways. The island of Cuba itself is endowed with valuable natural resources, including fertile agricultural land, rich mineral deposits, oil fields, excellent deep water ports and, of course, its beautiful beaches, mountains, historical architecture and other tourist attractions.

In spite of these sparkling possibilities, however, Cuba's economy is currently not just limping, but crawling along. While some reforms have been implemented, they have been carefully limited to preserve the regime's control over individuals' livelihood. These tight limits on reform have also greatly reduced their economic impact; changes have been far too circumscribed to provide Cubans with adequate freedom and incentive to produce what is needed in the quantities required. Cuban industries are operating at a fraction of their capacity, and shop shelves are largely empty except for dollar stores selling imported products.

The Cuban government has so far sought to avoid more meaningful reform by aggressively courting foreign investment. While the regime has claimed $1.5 billion in such investment, and alluded to U.S. businessmen making secret visits to Havana, the fact remains that most investors remain leery of Cuba's centralized and arbitrary investment approval process, the regime's still pervasive involvement in the economy and the risk of political instability. Foreign businesses still may not hire Cubans directly, but must go through a government agency. They may only in rare instances sell to the domestic Cuban market.

These and other factors have meant that investment to date in Cuba has been limited to relatively few sectors, particularly tourism, and has largely been structured to provide rapid return on investment and ease of exit should that prove necessary. The idea that "all the good investments will be gone by the time Americans get in" is ludicrous. There is no question that when change finally comes in Cuba and U.S. businesses move in, there will be a wealth of opportunities for them. The U.S. proximity to Cuba, Cubans' continuing affinity for American products and the strong cultural and historical ties that bind our two countries will mean that U.S. commercial involvement in Cuba is destined to be deep and beneficial to both Cubans and Americans.

When democratic change does take place in Cuba, Cuba will certainly take its place in our developing hemispheric economic system. The normalization of our trade relationship could proceed along three lines.

First, both Cuba and the U.S. are members of GATT/WTO. We would thus provide a democratic Cuba with MFN access to our market. American businessmen would compete in Cuba on an equal footing with firms of other countries.

Second, a democratic Cuba would be welcome to participate in hemispheric efforts to build a Free Trade Area of the Americas (FTAA). Hemispheric trade ministers are meeting today in Denver to take the first concrete steps towards the goal of completing an FTAA by 2005. The FTAA will provide opportunities for smaller economies like Cuba's to enhance economic growth and development. Cuba cannot be welcomed into this family, however, until it has embraced the same democratic and free-market principles that unite the rest of its members.

Third, the United States could extend trade benefits to Cuba equivalent to those of other countries of the Caribbean Basin once Cuba meets the same requirements. This would include duty free treatment under the Caribbean Basin Trade Security Act and NAFTA-parity legislation which you, Mr. Chairman, are sponsoring, if approved by Congress.

While the resurrection and re-integration of the Cuban economy will have immediate benefits for both Cubans and Americans, particularly Americans in Florida and other Southern States, there will be difficult obstacles to overcome. Among these will be deteriorated infrastructure on the island, the Cuban people's lack of recent experience with free markets, the lack of institutions to support a free market economy, and perhaps thorniest of all, the resolution of property claims. There are currently almost $6 billion worth of certified U.S property claims (including interest value). Cuba will face many more uncertified claims held by Cuban Americans who have become citizens since their property was confiscated by the Cuban Government, and still more claims from Cubans still on the island. The Cuban Goverment created this mess through its uncompensated expropriations thirty-five years ago. It will be the task of a future Cuban Government to put things right. The U.S. Government will pursue satisfactory resolution of U.S. claims in accordance with international law.

The U.S. Government will strongly encourage transition and democratic Cuban governments to resolve all property claims promptly and appropriately. The U.S. will strongly support the creation of a mechanism under Cuban or international law to do so. We will encourage restitution of property in cases when that would be appropriate. The U.S. may also pursue a government-to-government settlement agreement. The Department of State has been quite successful in gaining significant compensation for U.S. claimants from a number of countries in the last several years, and we may puruse a similar outcome in Cuba. We cannot predict what form the solution to this problem will take now, but we are confident that a solution will be found. Early resolution of claims will be essential not only for the sake of claimants, but also to firmly establish property rights for future Cuban and foreign investors, to clear obstacles to privatization, and to heal old wounds in Cuban society.

It is important for us to begin planning now how the U.S. Government, as well as other governments and institutions could most effectively support future transition and democratic governments in Cuba. Strong U.S. support would be crucial during a transition both to help meet humanitarian needs and to assist in building democratic and free market institutions. Early involvement by the international financial institutions (IFIs) in Cuba once a democratic transition has begun will also be essential to help stabilize the Cuban economy and provide incentives for the new government to undertake difficult but necessary economic reforms.

Perhaps the most important U.S. contribution to the re-building of Cuba, however, will be made by our private sector. U.S. business will be extremely competitive in nearly all sectors in Cuba, including housing construction, repair and expansion of physical infrastructure, agriculture, mining, oil extraction, developing financial service networks, telecommunications, transportation and, of course, tourism. Some studies have predicted that within a few years after a democratic transition, visitors to the island could more than triple, to over 2 million per year. The island will also be an extremely attractive location for U.S. investors in light industry manufacturing. Cuba will also constitute an excellent market for all types of U.S. products. The opportunities will be there, and I believe we can all be confident that American business will take full advantage of them.

Mr. Chairman, thank you again for this opportunity to reaffirm the Administration's commitment to expanding our economic links in the Americas, and our fervent desire to do all we can to help a democratic Cuba re-join our hemispheric family.

Chairman CRANE. Thank you, Mr. Casey.

Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

What is all this business about our administration not having any policy with Cuba? You spelled it out to me.

How are we going to get rid of Castro? That is the part I missed.

Mr. CASEY. That is the part I am not in a position to explain. We do not—as Mr. Deutsch said—we do not have a list of candidates, a scenario for the shape of a new Cuban Government with the passing of Fidel Castro.

We have a set of policies in place which we hope and believe will lead to a peaceful transition to democracy, but——

Mr. RANGEL. Peaceful transition?

Mr. CASEY. That is what we are seeking, Mr. Rangel.

Mr. RANGEL. Who would you negotiate with? Castro and his brother?

Mr. CASEY. It is an open question as to whether we would negotiate with anyone to achieve that peaceful transition. There is no detailed game plan that I am aware of that sets out how this is going to happen.

A transition to democracy will require the Cuban people largely to make it come about, not the United States.

Mr. RANGEL. Some people believe that the Cuban people should get so frustrated as a result of this tightening of an embargo that they just get fed up and revolt. If they did, would the United States support the revolution?

Mr. CASEY. I believe we would support actions by the Cuban people to restore democracy in that country; yes, sir.

Mr. RANGEL. By taking arms?

Mr. CASEY. If the Cuban people took up arms against the Castro regime——

Mr. RANGEL. Exactly.

Mr. CASEY [continuing]. I hardly imagine that we would oppose such an action.

Mr. RANGEL. No. I should have asked: Would we support it? Would we send arms? Would we send troops? I mean, do we get this thing over once and for all?

If these fragile, hungry people decide that the only way out of this is to overthrow this dictatorship, then with all of the rhetoric we have given about wanting to get rid of Castro, would we not just lead them up to the revolution and just say, you know: You are on your own.

How far would we go?

Mr. CASEY. I am afraid at this moment I am not in a position to respond directly to that question, sir, to say what we would do in that hypothetical situation.

Mr. RANGEL. But you can lead up to the point that we would support the physical overthrow of Castro by the Cuban people?

Mr. CASEY. If it were to come to that. Our hope is that the transition will be a peaceful transition, and that is what we are seeking, and that is what we have underlined as our policy.

Mr. RANGEL. And the main thing that would bring about the peaceful transition would be the embargo? Is that our main thrust?

Mr. CASEY. The main thrust of bringing about the peaceful transition is the Cuban Democracy Act, and the embargo is one element of the Cuban Democracy Act.

Mr. RANGEL. OK. But it is the main element. I mean, that is the main force, right?

Mr. CASEY. It is the main element of pressure——

Mr. RANGEL. That is what I meant.

Mr. CASEY [continuing]. On the Cuban Government.

Mr. RANGEL. Now has that pressure been effective as relates to impacting the Cuban Government?

Mr. CASEY. We believe, yes, that it has, and it has particularly been effective in the last 3 years with the elimination of massive Soviet support for the Cuban Government.

Mr. RANGEL. So you believe the embargo is working?

Mr. CASEY. Yes, we do believe the embargo is working. And we further believe that the actions that the Castro government has taken, that Fidel Castro has taken, to introduce the reforms that he has introduced up to now, which we find frankly rather pallid, are the result of the embargo and not the result of any sort of conversion to capitalist sentiments on the part of——

Mr. RANGEL. So you think that Castro is caving in as a result of the impact of the embargo, that he is changing?

Mr. CASEY. We believe that he is compromising his ideological views in order to deal with an increasingly difficult situation, part of which is brought on by the embargo, but which is largely brought on and largely caused by the wrongheaded policies that have been followed in the country over the last 35 years.

Mr. RANGEL. And so this should be our government's theory, that this should lead to a peaceful transition?

Mr. CASEY. This should lead, we hope, to a peaceful transition and to other forces within the country acting to eliminate or to avoid a total economic catastrophe within the country.

Mr. RANGEL. And if our lives depended on it, we could not think of anybody that would be involved in these, "other forces" in Cuba?

Mr. CASEY. I am not in a position to speculate as to who specifically.

Mr. RANGEL. But if there is——

Mr. CASEY. If there are——

Mr. RANGEL. But if there is, it is a secret, right?

Mr. CASEY. No, it is not a secret. It is just, to be frank, that I had come up to look at the posttransition, post-Castro economic situation.

Mr. RANGEL. But right now, we have not the slightest clue who these other forces——

Mr. CASEY. Well, there are—there are forces within the country. There are——

Mr. RANGEL. Great. I mean, could you share them with me?

Mr. CASEY [continuing]. Figures within the country who are working for reform and working for democracy.

Mr. RANGEL. Terrific. I just want to know, could you share them, or is it secret?

Mr. CASEY. I would be happy to share them with you, sir.

Mr. RANGEL. How about all of us?

Mr. CASEY. I would be happy to share them with all of you.

Mr. RANGEL. Well, who are they?

Mr. CASEY. I do not have that information at hand.

Mr. RANGEL. But you know they are there.

Mr. CASEY. But I would be happy to share what information we have.

Mr. RANGEL. Who would have the information? There we go. Thank you.

Mr. CASEY. Well, if you could let me simply take that question, I will get back and provide you very rapidly with all the information we have on the subject.

Mr. RANGEL. I mean, but would this information come back with any secrecy or top secrecy? I mean, what are we talking about? Are these people undercover?

I mean, I do not want to jeopardize anyone's lives. I mean, if we have got people over there that want a democratic government and that we believe have the ability to assist us in a transition, as we have had in so many countries, I do not want any CIA secrets.

But, I mean, you would know that publicly there is someone there, because I have never heard this before?

Mr. CASEY. I think we need——

Mr. RANGEL. I thought they all were in Miami.

Mr. CASEY. I think we need to turn it around. It is not Cubans either in Miami or in Havana who are going to assist us with the transition.

Mr. RANGEL. Not us.

Mr. CASEY. It is our hope that we will assist a Cuban leadership which emerges in the transition.

Mr. RANGEL. Right. Who is that Cuban leadership?

Mr. CASEY. I would be happy to take that question and come back to you, sir.

Mr. RANGEL. It is possible that we do not know anybody, though, is it not? It is possible that we do not have the slightest clue as to who the leader would be against Castro.

Mr. CASEY. It is possible that we, sitting here today, cannot name that person, just frankly as it is possible that we cannot name candidates for leadership in this country sometime in advance.

Mr. RANGEL. Thank you, Mr. Casey.

Chairman CRANE. Thank you.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Casey, a very interesting exchange to say the least.

Let me ask you, Mr. Casey, in a following up on Mr. Rangel's line of questioning, what type of military support would you foresee the United States providing an internal effort to overthrow Castro?

Mr. CASEY. Let me repeat, sir, that right at this moment, I cannot speculate at all on a hypothetical uprising in Cuba and what sort of response the United States would make to that.

I would be happy, as I told Mr. Rangel, to come back to you or to the committee with a response to that question.

Mr. RAMSTAD. But it was my perception of your response to Mr. Rangel's question that you would foresee the United States providing some sort of military support.

Mr. CASEY. I would just repeat that I cannot, sitting here right today, give you a response to that hypothetical question, and I will be happy to come back to it following the hearing.

Mr. RAMSTAD. Well, I know Mr. Rangel is a better questioner than I am, because I think he has already elicited that response, at least that there would be support forthcoming.

Let me shift gears. What is the administration's policy concerning the return of property expropriated by Castro to their rightful owners?

Mr. CASEY. Well, we—as I mentioned in my statement, we fully support that return, and we have made very clear not only to the Cuban Government, but to other foreign nations and potential foreign investors about our concern of third-country investors getting involved in expropriated U.S. properties in Cuba, and——

Mr. RAMSTAD. So the U.S. Government, if I may interrupt, Mr. Casey, will seek the return of those properties to their owners?

Mr. CASEY. Absolutely, absolutely. And we fully anticipate that a transition, democratic Cuban Government would agree to a mechanism for achieving prompt and adequate compensation for property which was expropriated by the Castro regime.

Mr. RAMSTAD. Let me ask a followup question: Has this issue been raised with our trading partners who might have purchased such expropriated property?

Mr. CASEY. The issue has been and is raised on a regular basis with our trading partners, and they are fully aware of our position and of our determination to seek either return of the property or compensation at the appropriate moment.

Mr. RAMSTAD. Again shifting gears, do you have any projections as to the level and composition of U.S. trade with a democratic Cuba?

Mr. CASEY. No, we do not. It is difficult to make those kinds of projections, you know, on the basis of a sort of uncertain evolution in the Cuban situation and the Cuban economy.

We are very confident that we would have really major, major opportunities. And with the opening up, I mean, if you posit the opening of the Cuban economy, of a market-oriented economy in Cuba, you posit significant inflows of investment from the United States, of a surge in remittances from Cuban-Amercans in this country, and of significant investment opportunities being rapidly presented to U.S. investors.

We believe that there would be a real surge in trade. Cuba is a natural trading partner of the United States, given its proximity. In the pre-Castro days, 90 percent of Cuban imports came from the United States.

One might make an analogy to Mexico, which is also a very important trading partner of the United States, and the vast bulk of their commerce is with the United States, simply because of proximity. And you can say the same about Canada.

And so we think the situation in Cuba would be much the same.

Mr. RAMSTAD. Well, thank you, Mr. Chairman and Mr. Casey. I just hope the administration, like the Congress, will do everything possible to keep the pressure on Cuba, or Castro rather.

Thank you, Mr. Chairman.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and thank you, Mr. Casey for your testimony.

It seems that we all here hope to achieve the same thing. We all hope to achieve the transition from an economy in Cuba, a command economy, one that does not work, to a free market economy, a transition to a democratic system.

It would seem to me that if we look at just the facts that we have about the Cuban economy, I think it is indisputable that things there are not working, and they are not getting better.

And since we do desire for this transformation to occur and since we would like for it to be a peaceful transition, has there been any thought of having a way to approach Castro himself, raise this issue and say: You of all people, on behalf of your people, ought to be the person who would want this transition to occur and to determine if that is not a possible route as opposed to other routes that we have discussed here today?

Mr. CASEY. We have a continuing dialog with the Cuban Government. We have a U.S. Interest Section in Havana, and the Cubans have a Cuban Interest Center here in Washington. And so they are under no illusions about our feelings about the current regime and how best to have such a transformation or a transition to democracy occur, which is peacefully.

So that I do not think it is a question of Fidel Castro being unaware of our views or that somehow a face-to-face conversation would enlighten him about what he might best do.

There is a relationship and a dialog which does go on between the two countries.

Mr. PAYNE. Do you feel that there is any likelihood that Castro would play a role in terms of moving Cuba in a positive direction such as we have been discussing today?

Mr. CASEY. There has been no indication to the present. Our policy and our desire for a transition is not tacked to personalities.

And we would welcome real and irreversible actions on the part of the current regime to liberalize and to open up the economy both politically and economically.

But there have been no indications that Fidel Castro is prepared to do this, and most particularly in the political area, in the area of civil liberties and human rights.

Mr. PAYNE. Are you aware of what the plans are in terms of how they intend to address the situation where the economy continues to worsen, according to all reports?

Mr. CASEY. I must confess I have no real knowledge of what the Cuban Government's plans are in terms of responding to a continually declining economic situation.

Part of their response has been the modest reforms which they have taken up until now. Part of their response is to try and reach out to foreign investment and to get some relief in that fashion.

Much of what has been discussed today about 100 percent ownership, foreign investors being able to come in with 100 percent foreign capital, et cetera, are simply proposals at this point. In other words, these are not things that have already happened. These are things which the Cuban Government is talking about. And it is clearly seeking to relieve its tremendous foreign exchange bind by encouraging others to come in.

But prior to coming up here, I looked at a summary, not done by the State Department, but by some outside researchers, of the kinds of investments that are going into Cuba. And even in the tourism area, which is one of the most, if you will, talked about, they are largely management contracts. In other words, by and large, you do not have foreign companies coming and putting up the cash to build hotels, et cetera. They are coming in on a purely management basis, which means they could fold up, you know, in a week and leave.

The major foreign investment coming in is in the mining area. And if you move outside of the mining area, there is really very little.

There is no, to our knowledge, drilling, for example, going on around Cuba by foreign, French or Mexican or other foreign petroleum companies. There is a lot of looking, but not much doing.

Mr. PAYNE. Well, it is no surprise that people would not want to invest in a failed economic system. And clearly it is a failed system; it has failed. Other countries, the demise of the Soviet Union and communism around the world, are certainly great evidence of that, and I would hope that very quickly events can occur that would bring Cuba into a positive mode, into an economy and a political system that does, in fact, work.

And thank you, Mr. Chairman.

Chairman CRANE. Thank you.

Mr. Zimmer.

Mr. ZIMMER. Thank you, Mr. Chairman.

I would like to ask a few questions about sugar. Despite Cuba's efforts to diversify its economy, sugar is still the major export from that nation. And I would like to know, after Castro is gone and democracy is restored, whether the United States will restore the sugar quota for Cuba that existed before Castro?

Mr. CASEY. There have been no decisions made about how the Cuba quota will be handled. In other words, the whole system under the Sugar Act, as you are aware, are individual country quotas based on a specific historical record of exports into the United States.

And I do not believe—I am not aware that any decisions have been taken at this point as to what the shape of a Cuban quota might be. I think it is premature right now to be considering that.

Mr. ZIMMER. Well, let me ask some basic questions. Will we have any quota for sugar from Cuba after Castro?

Mr. CASEY. My assumption is that we will; yes, sir.

Mr. ZIMMER. In 1958, the quota was 3.2 million metric tons. Can you give me any indication of what you think would be the appropriate size of the quota?

This is a very important issue as it relates to the viability of a democratic Cuba. We were the major importer of Cuban sugar in the past. And without the ability to export to the United States, Cuba is going to be at a considerable disadvantage.

Can you give us any idea of what the magnitude of the quota would be?

Mr. CASEY. Sitting right here, I cannot. But I would be happy—if you would give us a written question, I would be happy to get back to you expeditiously——

Mr. ZIMMER. Yes.

Mr. CASEY [continuing]. With the best estimate.

Mr. ZIMMER. All right. And I hope the estimate is a number, because——

Mr. CASEY. I will take that onboard, sir.

Mr. ZIMMER. All right. Now assuming—and I guess you do say that we will have a Cuban sugar quota; the only question is the size—will the quotas for other countries that export sugar to the United States be reduced as a consequence?

Mr. CASEY. Under the current legislation, that would be necessary, and that is why I do not want to get right at this hearing deeply into the details of the sugar program, because frankly I am not that well acquainted with it to be able to answer these kinds of questions. We could add that to the response.

But basically—as I understand the Sugar Act today, there is a global quota which is divided among countries. So perforce, if there is any quota for Cuba, the pie would have to be redrawn.

But, you know, there are any number of options and any number of ways ultimately that this can be handled, that again I cannot get into here as to how ultimately this question is going to be resolved, because we recognize the fact that, yes, sugar exports are a very important element of Cuba's economy, at least today.

Mr. ZIMMER. Your responsibilities are principally political, and I can understand why you will not want to get into the technical details of the sugar program.

But speaking as a political matter, if the quotas for other countries were reduced as a result of allowing imports of Cuban sugar to the United States, would we not be harming other emerging democracies in Latin America and around the world, because most of our sugar, as I understand it, comes from countries that are struggling to establish a free market and a democratic system. And if we withdraw sugar allocations, will we not be hurting them?

Mr. CASEY. Well, the very nature of a quota arrangement is that it is a zero sum game, that if the quota is fixed, the various portions have got to be given out in relation to the global. And therefore, yes, if a portion of that quota were to go to Cuba, then it would clearly have to come out of the quotas of other countries.

And that is why it is, obviously, a difficult and sensitive question as to how this would be managed. And it is, to my knowledge, not a question that has as yet been addressed in any detail. But it is not—as you might know, not in our bailiwick.

Mr. ZIMMER. Well, speaking politically again, because of the political implications of playing a zero sum game, do you believe that it might be desirable for the United States to increase the quota of sugar imports and provide somewhat less protection to our domestic sugar producers because of the adverse political impact that dividing up this limited pie would have?

Mr. CASEY. I would rather not express my personal views on whether it might be desirable. It will ultimately be a question that will be addressed in the administration and a decision reached when the appropriate moment arrives.

Mr. ZIMMER. I will ask for a written response to that from the administration as well.

Thank you.

Chairman CRANE. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Just a couple of quick questions.

Mr. Casey, is it your suggestion this afternoon that Castro is in firm control of the military?

Mr. CASEY. That is our understanding.

Mr. NEAL. Are there any leading voices of dissent that represent any immediate threat to his tenure?

Mr. CASEY. No, not significant threats to his current standing with the military. No.

Mr. NEAL. So given those two suggestions, would you suggest that it is the continuing economic pressure that probably does more than anything else to bring about the structural changes in the Cuban economy at this time?

Mr. CASEY. Well, it is twofold. It is the continuing bad domestic policies and the external economic pressure that the United States is able to bring to bear.

But we believe that, you know, the fundamental problems with the Cuban economy are not the result of the embargo. The fundamental problems that the Cuban economy has are the result of the policies which the country has unfortunately followed for more than three decades.

Mr. NEAL. Has Castro's star faded significantly in the Caribbean?

Mr. CASEY. I think his star has faded significantly throughout the hemisphere. He still carries a certain aura by reason of his personality. But he is not a model for anyone in the hemisphere, either politically or economically.

Mr. NEAL. The democratic changes in the Caribbean and throughout Central America have indeed been rather extraordinary over the last decade, have they not?

Mr. CASEY. Absolutely, absolutely. And not only democratic changes, but economic changes, because there have been very, very significant improvements in economic conditions in many of the countries. And frankly it is through the Caribbean Basin arrangements that a lot of this transformation of economies has been made possible.

Mr. NEAL. Thank you. Thank you, Mr. Chairman.

Chairman CRANE. Thank you.

I have just one quickie question before we bring the next panel up.

Cuba was one of the original members of GATT, and they have continued to retain that membership. And while we have a special relationship within the agreements of GATT and WTO with them, are they, in your estimation, basically, though, faithfully adhering to the agreements under GATT and WTO?

Mr. CASEY. That is a question I will have to take, sir. I will be honest with you. I do not know.

I cannot imagine frankly that a centrally planned economy without prices and production costs and totally dependent upon subsidized inputs from elsewhere, at least until recently, could be held up as any model of the kind of trade behavior or international trade behavior that either the GATT or the WTO is seeking to promote in the world.

Chairman CRANE. Well, if you have any additional information on that issue, I would appreciate it.

And with that, I want to thank you, Mr. Casey, for giving of your time and energies. And that concludes this panel.

And the next, I would like to get seated, please: Mr. Sweeney with Heritage Foundation; Dr. Jatar, senior fellow with the Inter-American Dialogue; Wayne Smith with the Center for International Policy; and William Rogers, senior partner, Arnold & Porter.

And as you know, we are on tight constraints, but anything beyond your oral remarks within the general confines of about 5 minutes will be made a part of the permanent record.

And with that, we will start out with Mr. Sweeney.

STATEMENT OF JOHN SWEENEY, POLICY ANALYST, TRADE AND INTER-AMERICAN AFFAIRS, HERITAGE FOUNDATION

Mr. SWEENEY. Mr. Chairman, Mr. Rangel, members of the committee, thank you for the invitation.

The communist Cuban State built around Fidel Castro's dictatorship has pervaded all activities and sectors of life in Cuba for decades, ruining the national economy and destroying civil society.

The United States was, and will be again, Cuba's most important economic partner. After Castro's downfall, many economists expect that Cuba once again will become one of America's most important trading partners in the Caribbean region. As such, the United States should be prepared to assist Cuba in its transition to a free market economy as soon as Castro falls from power.

Specifically, the United States should begin with five broad actions.

First, after Castro falls from power, restore Cuba's most-favored-nation trade status.

Second, establish a framework for a free trade area with Cuba. Restoring most-favored-nation status will help Cuba to attract investment capital in the near term.

But as Cuba overcomes the initial difficulties of reorganizing its ruined economy, the United States should be prepared to start negotiating a free trade agreement with Cuba. Such an agreement would remove all trade tariffs and nontariff barriers between the two countries. In the longer term, the United States also should bring Cuba into the North American Free Trade Agreement with Mexico and Canada.

Third, restore Cuba's share of U.S. sugar quotas to levels comparable to what existed in 1958. To give Cuba a market for its main crop, the United States should restore a substantial portion of Cuba's 1958 annual sugar quota of 3.2 million tons per year after Castro falls.

In the long term, Cuba must diversify its economy, however, and increase foreign exchange earnings in tourism, manufacturing, and numerous agricultural goods. Yet access to the U.S. sugar market would allow Cuba quickly to gain much needed hard currency earnings.

Fourth, resist the temptation to send large quantities of economic assistance and rather provide only emergency humanitarian assistance. Cuba might well be the one country that emerges from communism without even a plausible pretense for foreign aid. The 2

million Cubans living in the United States and elsewhere, who are expected to provide as much as $3 billion a year of direct private investment and technology assistance to a free Cuba, make unnecessary any Multilateral Development Bank aid to Cuba. And the failure of the U.S. Agency for International Development over three decades to bring prosperity to less developed countries suggests that little good can be expected from bilateral foreign aid.

Finally, the United States should use its influence with such organizations as the Inter-American Development Bank, the World Bank, and International Monetary Fund to block all types of loans and grants to Cuba. These institutions have a long and sad history of funding the very types of government-controlled economic policies that have maintained poverty and economic stagnation in less developed countries.

Fifth, when Castro is gone and immediately following elections in Cuba, the United States should eliminate the trade embargo, but not before.

Now what should the new Cuban Government do after Castro departs from the scene? I can think of seven broad areas where they should act.

First, the new Cuban Government after Castro should quickly privatize State-owned enterprises and eliminate all State monopolies. Foreign investors could be allowed to purchase shares in such firms after the U.S. trade embargo has been lifted; however, any business asset that existed before the Castro revolution and still exists after Castro should first be offered back to the original owners.

Recently, investors from many countries, such as Canada, Mexico, Spain, and Germany, have acquired assets confiscated without compensation from their original owners by the Castro government. The post-Castro government should not hesitate to return this property to its rightful owners, many of whom have filed legal claims to the property since it was confiscated.

The second step the new post-Castro government could take in Cuba would be to eliminate all abusive Government regulations and establish a quick one-step process for obtaining business licenses.

Third, establish a stable, convertible currency.

Fourth, establish a legal and institutional framework to protect private property. The core of the free market system from which all other principles derive is the right of individuals to own and dispose of private property as they see fit. Proclaiming the rights of individuals to own private property is relatively easy. More difficult is guaranteeing these rights, especially against government expropriation and abuse and providing the means for their protection. Privatization, free enterprise, and a stable currency will bring prosperity only if economic liberty, the right to own property and to contract freely with others to trade that property, is protected by the new post-Castro government in Cuba.

Finally, liberalize trade and eliminate restrictions on foreign investment. A free market Cuba should begin by bringing its trade practices into line with the General Agreement on Tariffs and Trade. Cuba should start by complying with the harmonized tariff

classification and coding system to bring its trade accounting methods in line with the rest of the world.

Cuba, in addition, should amend and clarify its customs laws to harmonize them with international trade standards.

While some claim that Cuba has made some progress already in opening its economy to investments and imports, Castro's Cuba remains a far cry from being a free and open market today.

And with that, I will stop—I see my time is up—with the concluding comment that the rest of my testimony outlines more completely what we at the Heritage Foundation believe should be U.S. economic relations with Cuba after Castro.

Thank you.

[The prepared statement follows:]

Testimony Before the Trade Subcommittee
of the House Committee on Ways and Means
June 30, 1995

U.S. Economic Relations with Cuba after Fidel Castro's Downfall

by John Sweeney
Policy Analyst
Trade and Inter-American Affairs
The Heritage Foundation

The communist Cuban state, built around Fidel Castro's dictatorship, has pervaded all activities and sectors of life in Cuba for decades, ruining the national economy and destroying civil society. The United States was, and will be again, Cuba's most important economic partner. Located only 90 miles from American shores, Cuba's economy was highly integrated with the U.S. before Castro's communist revolution. After Castro's downfall, many economists expect that Cuba once again will become one of America's most important trading partners in the Caribbean region. As such, the U.S. should be prepared to assist Cuba in its transition to a free market economy as soon as Castro falls from power. Specifically, the U.S. should:

◆ **Restore Cuba's most favored nation trade status.** Cuba was one of the original signatories of the General Agreement on Tariffs and Trade in 1948. Yet, since Castro's takeover in 1959, Cuba has not respected GATT rules and procedures. Further, in 1962 the U.S. revoked Cuba's most-favored nation status, which provides each GATT member with equal trade treatment. This status was revoked because of Castro's increasing anti-Americanism. In February 1962, the U.S. imposed a trade embargo against Cuba.

◆ **Establish a framework for a free trade area with Cuba.** Restoring most-favored nation status will help Cuba to attract investment capital in the near term. But, as Cuba overcomes the initial difficulties of reorganizing its ruined economy, the U.S. should be prepared to start negotiating a free trade agreement with Cuba. Such an agreement would remove all trade tariffs and most non-tariff barriers to trade between the two countries. In the longer term, the U.S. should bring Cuba into the North American Free Trade Area with Mexico and Canada.

Framework Agreements. U.S. trade negotiators first should work with a free Cuba to establish the framework agreements necessary to bring Cuba into the North American Free Trade Area. These framework agreements, already negotiated with most Western Hemisphere countries, establish the basis for which free trade negotiations will take place. Framework agreements often set out target dates for negotiations, topics of discussion, and the objectives of such discussions. The U.S. then should negotiate a free trade agreement bilaterally with Cuba, and subsequently should extend NAFTA membership to Cuba.

A post-Castro Cuba will likely become America's most important trading partner in the Caribbean region, as well as an attractive country for American investors. And with 2 million Cuban exiles now in Florida, it may be all but impossible to stop free trade and investment from developing spontaneously. Therefore, it would greatly benefit both the U.S. and Cuba if a free trade agreement were established soon after democratic elections are held.

◆ **Restore Cuba's share of U.S. sugar quotas to levels comparable to what existed in 1958.** Sugar production accounted for 80 percent of Cuba's exports between 1920 and 1959. Today, sugar is still Cuba's largest export, but it makes up only about 55 percent of the country's total exports. U.S. sugar growers have enjoyed trade protection almost continually since 1816. In 1934, the U.S. government established a quota system that restricts imports from each sugar exporting country. Cuba's quota in 1958 was 3.2 million metric tons. But the U.S. trade embargo has barred Cuban sugar

exports to the American market. Since the trade embargo was first imposed more than three decades ago, the U.S. government has reduced the amount of imported sugar, substituting domestic sugar production. Today, America's sugar producers enjoy the highest levels of protection ever.

To give Cuba an immediate market for its main crop, the U.S. should restore a substantial portion of Cuba's 1958 annual sugar quota of 3.2 million tons after Castro falls. In the long term, Cuba must diversify its economy and increase foreign exchange earnings in tourism, manufacturing, and numerous agricultural goods. Yet, access to the U.S. sugar market would allow Cuba quickly to gain much-needed hard currency earnings.

Higher sugar imports will lower prices for American consumers and for American enterprises that use sugar in their products. Studies have shown that U.S. sugar quotas cost Americans anywhere from $600 million to $3 billion a year in higher prices. To lighten the burden on American consumers, the U.S. should open its sugar market to foreign competition. The emergence of a post-Castro free Cuba would give U.S. policy makers an ideal opportunity to begin to scrap America's sugar quota system.

◆ **Resist the temptation to send large quantities of economic assistance and, rather, provide only emergency humanitarian assistance.** Cuba might well be the one country that emerges from communism without even a plausible pretense for foreign aid. The two million Cubans living in exile in the U.S. who are expected to provide as much as $3 billion a year of direct private investment and technology assistance to a free Cuba make unnecessary any multilateral development bank aid to Cuba. And the failure of the U.S. Agency for International Development (AID) over three decades to bring prosperity to less developed countries suggests that little good can be expected from bilateral foreign aid. Experience in Eastern Europe following the collapse of the Soviet Empire demonstrates that massive infusions of foreign aid are of little consequence in the development of free markets. Rather, free enterprise and open investment policies spontaneously have created economic growth in many countries like the Czech Republic.

The new Cuban government might be tempted to take as much foreign aid as is offered, ostensibly to pay for the costs of a transition to a market economy. The U.S. should not hold out such a temptation. Rather, after a post-Castro Cuba has not held democratic elections, the U.S. should offer assistance only for emergency food or medical help. By using aid in this way, the U.S. is assured that its efforts truly help Cuba and do not get it addicted to aid.

Finally, the U.S. should use its influence with such organizations as the Inter-American Development Bank (IDB), the World Bank, and the International Monetary Fund, to block all types of loans and grants to Cuba. These institutions have a long history of funding the very types of government-controlled economic policies that have maintained poverty and economic stagnation in most less developed countries.

◆ **Abolish the trade embargo.** When Castro is gone, and immediately following free elections in Cuba, the U.S. should eliminate the trade embargo, but not before. American businesses should be given an opportunity to trade and invest in Cuba as quickly as possible.

Economic Reform.

Post-Castro Cuban leaders will face the need to revive a dead economy quickly, to provide basic goods and services, and in the long term to ensure economic growth and prosperity for all Cubans. In this, Cuba can learn from the experiences of other less-developed and ex-communist countries which economic policies work best and which should be avoided. Leaders of a free Cuba also would do well to study the success stories of Taiwan, South Korea, Singapore and Hong Kong, which have moved from the less-developed to the developed world. Moreover, leaders of a free Cuba would do well

to study the reform process of such former Soviet republics as the Czech Republic and Estonia, which have made significant progress in tax reform, foreign investment and banking reform, among other essential economic policies.

Future leaders of a free Cuba also should remember that there was considerable corruption in the pre-Castro Cuban government. Not all Cubans felt that they shared in the benefits of the free market. Indeed, frustration over perceived or real limits on opportunity caused some initially to support Castro. But rather than granting equality of opportunity, Castro made all Cubans equally poor. To avoid the fear that a corrupt socialist regime will be replaced by a corrupt capitalist one, leaders of a free Cuba must take care to make their free market revolution a popular by creating economic liberty and opportunity for all Cubans.

The new Cuban government would do well to establish a check list of short and long term economic reforms aimed and ensuring that market conditions are favorable to economic growth.

The short term policies would include:

✓ **Quickly privatize state-owned enterprises, and eliminate all state monopolies.** Cuba must move quickly to privatize all state-owned enterprises. This is crucial because the sooner individuals, as owners of enterprises, can benefit directly from these efforts, the quicker the production of goods for consumption or trade will grow. Privatization in other ex-communist countries often has been delayed as policy makers sought to determine the value of state-owned assets before they were sold to private investors. One reason for this has been to guarantee maximum revenues to the government. Another has been to prevent prospective owners from paying too little for assets. But these reasons should be secondary to raising production as quickly as possible.

A new Cuban government will have at its disposal a wide range of techniques that may be used alone or in combination to transfer government assets into private hands quickly and efficiently. Smaller businesses could be sold directly to their employees. Larger enterprises might first be reorganized and sold to their workers under employee stock ownership plans. An enterprise reorganized as a joint-stock company might also be sold to the general public.

The Role of Foreign Investment. Foreign investors could be allowed to purchase shares in such firms after the U.S. embargo has been lifted. However, any business asset that existed before the Castro revolution, and still exists after Castro, should first be offered back to the original owners. For example, companies like Chrysler, Johnson and Johnson, Texaco, and a host of others, had their property confiscated by the Castro regime. These factories and business were then pillaged by the communist bureaucrats who took them over.

Recently, investors from many countries, such as Canada, Mexico, Spain, and Germany have acquired assets confiscated without compensation from their original owners by the Castro government. The post-Castro government should not hesitate to return this property to its rightful owners, many of whom have filed legal claims to the property since it was confiscated.

Reviewing Property Claims. In order to privatize state-owned assets and to make certain that previous owners recover their property or receive compensation, the new Cuban government should establish a privatization oversight agency and a property claims court. The oversight agency would coordinate and implement the privatization program. It also would process claims for confiscated assets. The independent property claims court, meanwhile, would review cases in which there are several claimants for a given asset, or other complications. In such cases, the privatization agency would act in accordance with the claims court decision. If such cases cannot be decided within an established time limit, the agency would proceed with its plans to dispose of assets. As a

result, privatization would not be delayed indefinitely. When the court finally reached a decision, the winners of the case would receive compensation.

The privatization agency might avoid court delays and conflicts by providing legitimate claimants to confiscated assets with "vouchers" equal in value to the size of their claims. These vouchers could be used to bid on state-owned assets being sold by the agency. Thus, former owners would be given preference over other investors.

✓ **Eliminate all abusive government regulations and establish a quick, one-step process to obtain a business license**. In many less developed countries, obtaining a business license requires countless bribes, many trips to government offices, and a long waiting period. In some cases, even after these businesses are granted a license, government bureaucrats nearly bankrupt them with the huge costs of complying with the haphazard application of countless regulations.

Rather than resort to oppressive government imposed regulations, Cuba would do well to establish "self-regulation regimes" like those that exist in the United Kingdom. These regimes are voluntary associations of businesses that produce similar products, and which establish their own product safety, health, and other standards. Each association has a label or trademark that appears on their products. It is up to the consumer to interpret which product offers the standards he or she feels is worth the cost of the product. Those companies that do not participate in the self-regulating regime cannot use the trademark, and thus are unable to claim that their products meet the standards set by their industry associations. Indeed, such self-regulating regimes could -- and should -- be established for many of the types of business regulations that exist today in developed countries.

In addition, the new Cuban government should establish a "one-stop-shop" for obtaining business licenses, and should even offer them through the mail. Such a system will allow potential business owners the opportunity to quickly set up shop without the cumbersome red tape that exists today in many other countries.

✓ **Establish a stable, convertible currency.** To facilitate economic activity, international trade, and privatization, the new government of Cuba should move quickly to establish a stable, convertible currency. A modern economy cannot flourish without a sound currency. A currency serves as a store of value, something people can save to use for later purchases or investments. It also functions as a medium of exchange, allowing businesses and individuals to trade with each other. To perform these functions, a currency must keep its value over time. That is, it must not be inflated.

Some reformers may suggest that Cuba's current central bank should be given the task of making Cuba's peso a stable currency after Castro goes. Yet, it was this bank that printed billions of worthless Cuban pesos to fund the budget deficits of Castro's communist regime, and to provide massive subsidies to the public sector. This is not uncommon for central banks in less developed countries with socialist governments and state-controlled economies. However, a free market economy needs a more efficient way to provide a convertible, non-inflationary currency.

Currency Board. Rather than working through the current system, the new Cuban government should abolish the deposed Castro regime's central bank and establish a system in which the currency could not be manipulated easily by the government. The new Cuban government simply could use the U.S. dollar for its currency. This, however, could create political problems. National pride might cause the Cuban people to not accept the U.S. dollar as "their" currency.

Johns Hopkins University economist Steve Hanke and George Mason University economist Kurt Schuler suggest that ex-communist countries set up independent currency boards to establish a convertible domestic currency and instill confidence in money by operating independently of the government. This is also a good prescription for a post-Castro Cuba.

A currency board issues notes and coins that are backed directly by a foreign currency, such as the U.S. dollar. Citizens and businesses could exchange these notes and coins for dollars, or any other established currency, basket of currencies, or commodities, at a fixed rate. Market forces, rather than a central bank, would determine the size of the money supply. Over 60 countries have utilized currency boards since 1900. Hong Kong and Singapore are notable examples of economies with very stable currencies overseen by currency boards. Hong Kong, for example, has had an average annual inflation rate of about seven percent since 1980. Singapore had an average annual inflation rate of 1.9 percent between 1980 and 1991.

✓**Establish a legal and institutional framework to protect private property.** The core of the free market system, from which all other principles derive, is the right of individuals to own and dispose of private property as they see fit. Proclaiming the rights of individuals to own private property is relatively easy. More difficult is guaranteeing these rights, especially against government expropriation and abuse, and providing the means for their protection. Privatization, free enterprise, and a stable currency will bring prosperity only if economic liberty, the right to own property, and to contract freely with others to trade property, is protected.

To achieve these goals, a new Cuban government should re-establish the commercial code of business that existed in Cuba before Castro. Such a code estabslishes the environment in which all economic activity occurs. It defines, among other things, what a contract is, what constitutes a buyer and a seller, and how disputes are arbitrated. An institutional framework, moreover, must exist to enforce contracts, and arbitrate disputes. An independent judiciary is necessary for objective resolution of disputes.

Understandably, after suffering for more than three decades under the repressive and arbitrary directives of communist bureaucrats, Cubans might regard all government officials as enemies. Thus, to give people confidence in a new system, post-Castro leaders must establish a new judicial system with its own binding, independent powers to protect the integrity of private property and the right to contract. This may require the complete abolishment of all existing communist courts, the appointment of a new judiciary, and a new Constitution based on principles of capitalist democracy.

✓ **Liberalize trade and eliminate restrictions on foreign investment.** Free trade is particularly important for countries attempting to overcome decades of economic decay under communism. High tariff and non-tariff barriers add to the costs of machinery, equipment, and other goods necessary to increase productive economic activity. Trade barriers also price consumer goods out of reach of many workers, lower living standards, and remove incentives to work hard and be productive.

Trade was very important to Cuba's economy before Castro, accounting for 57 percent of GNP. And the U.S. was Cuba's principal trading partner. Re-establishing trade ties with the U.S. and the rest of the world thus is a key to Cuba's economic recovery.

A free market Cuba should begin by bringing its trade practices into line with the General Agreement on Tariffs and Trade (GATT). Even though Cuba was an initial signatory of GATT in 1947, and remains a participating member to this day, it has drifted from the free market principles laid out in GATT. Cuba should start by complying with the Harmonized Tariff Classification and Coding System to bring its trade accounting methods in line with the rest of the world. Cuba, in addition, should amend and clarify its customs laws to harmonize them with international trade standards.

While some claim that Cuba has made some progress already in opening its economy to investments and imports, Castro's Cuba remains a far cry from being a free and open market. Cuba's customs officials are notorious for their corruption, often requiring bribes, kick-backs, and other special favors to release imported goods held at the ports of entry. In other cases, a scarcity of goods has provided incentives for these

corrupt customs officials to steal imported goods and keep them for their own use. Thus, Cuba's customs system will need to be entirely overhauled to root out these border bandits.

By removing restrictions on foreign investment, a free Cuba could receive as much as $3 billion in foreign investments from Cubans now living in exile, an infusion of capital not available to most ex-communist countries. A post-Castro Cuban government should make it easy for foreign investors to make their investments, with minimal central government involvement and oversight. An especially promising means of attracting foreign capital would be for Cuban enterprises to engage in joint ventures and strategic alliances with foreign investors. These alliances allow foreign companies jointly to manufacture products with private Cuban companies. In such arrangements, both partners gain by sharing the costs and information needed to produce an end product. As a result, newly privatized Cuban companies could greatly expand their access to new technologies, management techniques, distribution channels, and capital. To make joint ventures attractive, Cuba should avoid strict antitrust laws that discourage such alliances.

The longer term policies needed to build a capitalist democracy in Cuba would include:

✓ **Promote rapid development of competitive and efficient financial institutions, including stock and bond markets.** Financial institutions that direct funds to productive enterprises, such such as banks and stock exchanges, are vital for a functioning free market. Banks accept capital deposits, for which they pay interest, and lend out money to individuals and businesses, for which they receive interest, the "rent" they charge on money. Banks also help finance exports and imports, and purchase large blocks of stocks which they then market to other investors.

A new Cuban government thus should move quickly to establish a free banking system. In doing so, it should take a lesson from the U.S. on what not to do. The United States separates investment banking from savings and loan banking. This makes banks less diversified and therefore often less able to deal with economic hard times that might reduce profits for one banking activity but not for another. Thus, a new Cuban government should allow its banks to engage in all forms of banking activities.

Fostering Small Banks. A new Cuban government should pay special attention to the need for cooperative banks, which are operated on a small scale by locals who make loans mainly to one another. New goods, services, and jobs are generated primarily by small entrepreneurs. Larger banks often have limited capacity to evaluate the needs and credit-worthiness of such small businessmen. In many less developed countries, where strict banking laws favor large banks but hinder or bar the creation of smaller banks, the growth of small business is retarded, and the poorest people suffer as a result.

A new government in Cuba also should avoid America's banking insurance mistakes. Currently, the U.S. government insures banking deposits and charges the same rate whether a bank pursues reckless lending policies or sound ones. This is like auto insurance companies charging the driver who has had many accidents the same price as those who have never had an accident. By banning market pricing of insurance in banking, the U.S. government has removed the market incentive of high insurance rates that would discourage irresponsible or risky lending. This was a major cause of America's savings and loan crisis during the early 1990s.

To avoid this problem, a new Cuban government at minimum should charge market rates to banks for insurance. Better still, in the long term, Cuba should allow private insurance companies to underwrite the banks.

Competing Currencies. After Cuba has established marketing boards to stabilize its currency, it should consider developing a banking system based on competing currencies. Without a central bank, already abolished when currency boards are

established, normal monetary functions, such as check clearance facilities, need not be administered by the government. Private institutions should be established to clear checks and other forms of paper money.

This system is based on competing currencies, which is basically what bank supplied personal checks are. Each bank supplies its customers with a variety of competing currencies, like personal checks (another form of paper money), and bank-specific credit cards. Banks thus compete for customers. Such a system would instill maximum competition between banks and would virtually eliminate the possibility of government manipulation of the currency. Moreover, Cuba would be setting an example of a free market monetary and banking system that could become the model for other countries, including the U.S.

A sound stock market also is necessary to attract domestic and foreign investments. It also can assist government privatization efforts: a vibrant Cuban stock market would be an ideal place to sell off large state-owned enterprises.

✓ **Establish a tax structure that minimizes disincentives for economic activity.** A primary mistake of ex-communist countries over the past three years has been to set high tax rates, making it difficult or impossible for entrepreneurs to acquire the capital to begin or expand operations. Poland, for example, has a top income tax rate of 45 percent. Hungary has a top rate of 44 percent. Romania has a top rate of 60 percent. Such high tax rates undermine entrepreneurship.

These and other ex-communist countries claim that they need high taxes initially to raise the revenue to cover the costs of transition to a free market. But high tax rates hold down economic production, thus holding down revenues to the government and slowing the economic transition. Cuba thus would do well to hold tax rates low or eliminate them altogether to avoid these problems.

A Flat Tax for Cuba. Governments need revenue to provide such essential services as police protection, law courts, and national defense, but excessive taxation takes wealth away from private savers, and reduces the private sector's capacity to invest in new productive capacity that creates more jobs. Taxation provides a significant disincentive for individuals to engage in the type of activity that is being taxed. While the debate continues in less developed countries as well as in the industrialized world over what is the proper rate of taxation, and how with regard to how much taxation is too much, some countries do not even have income taxes. For example, the Bahamas, Bahrain, Paraguay, and Uruguay have no taxes on income.

The new Cuba should design a tax structure that balances the need to generate the revenue they feel is necessary to finance what they consider legitimate government operations with the disincentives inherent in any tax scheme. While the best possible tax system may be not to tax income at all, but rather raise revenues through user fees, a good tax system should target a broad tax base to insure the lowest possible tax rates. The best approach would be a flat income tax of a set percentage to be paid by all individuals. A flat tax avoids the disincentives to production that result from the form of tax that increases with higher income levels, called a progressive tax. The new government of Cuba also should avoid a business income tax altogether. The new government of Cuba might also set a limit on the size of its budget, relative to its gross domestic product. By holding down spending, the government would help assure that taxes remain low, and thus that the economy continues to expand.

Mr. SHAW [presiding]. Thank you, Mr. Sweeney.
Dr. Jatar.

STATEMENT OF ANA JULIA JATAR, PH.D., SENIOR FELLOW, INTER-AMERICAN DIALOGUE

Ms. JATAR. Thank you very much, Mr. Chairman, for this opportunity.

For the purpose of full disclosure, I would like to say that I am a Venezuelan citizen, born in Cuba, the country of my mother and my grandparents, and the country which I left when I was 2 years old.

I have submitted my written statement, which actually I did not see, but I have submitted it, where I analyze the recent economic performance and policy trends in the Cuban economy. I specifically evaluate the implications of the massive contraction of the Cuban economy after 1989; the reforms introduced by the government; and what I by far consider the most important issue, the dynamic generated by these reforms.

I would like to concentrate my oral presentation on the major conclusions of my written statement.

The Cuban economy seems to have touched bottom. GDP declines have stopped in 1994 after a 40 percent cumulative drop between 1989 and 1993. The economic reforms introduced so far and the drastic decline in output and imports suggest that the economy is ready for some sort of recovery. Foreign investment is increasing and reached $2 billion in 1994.

The reforms enacted so far do not respond to a coherent plan. Nevertheless, Cuba's piecemeal reforms have some similarities with the China-style strategy. It is opening up some sectors that it hopes will generate significant growth in exports and employment before it needs to reform other sectors.

This strategy, which is in great contrast with the big bang approach of speedy liberalization followed in the Eastern European countries and the former Soviet Union, requires Cuba to manage the contradictions of a dual economy. One sector of the economy remains under central planning, while a market sector with a different set of prices develops next to it.

An important question, though, is whether Cuba will be able to restore growth and keep distortions between the two coexisting economic systems from ripping the society apart through growing inequality, corruption, profiteering, or plain economic success.

I believe, Mr. Chairman, that my written statement supports the following propositions:

First, the Cuban economy is not about to collapse and will not do so under the pressure of further sanctions. In fact, it is more likely to start a recovery after the major and inefficient decline in output and income which took place between 1989 and 1993.

Second, government reforms have been led by the force of reality and not by conviction. The government is following a reactive, not proactive, stance. As reality impels civil society and the country into illegal or unauthorized activities, the government is forced to change the constitutional and legal framework in order to permit the inevitable.

This explains the legalization of holdings of dollars, of farmer markets, of farmer cooperatives, of self-employment, and of foreign ownership. The piecemeal economic reforms introduced so far are generating a market dynamic in some sectors which are slowly pushing further for new changes. If more markets are opened, the dynamics generated will force the government to make even more reforms.

Third, the greater the market opportunities faced by Cubans, the more the contradictions and the faster they will leave the current State-controlled system, which remains under tight party control. Hence, the elimination of the U.S. embargo is likely to accelerate the pace of the reform and the development of a more autonomous sector in the economy.

Fourth, Mr. Chairman, as the more market-oriented and independent sectors of the economy develop, there will be a wider and more autonomous constituency in favor of liberal democracy.

Fifth, tightening the embargo and placing the emphasis on property claims of those who were not U.S. citizens by 1960 will alienate important reform-minded sectors in Cuba and will strengthen the power of the Castro government. The last thing that any Cuban wants after wasting 36 years of their lives under a failed system is to start a new era with a regressive reallocation of the few assets that still remain in the island.

Finally, there is clearly an opportunity for a different policy. Suspending the embargo and inviting Cuba to the multilateral institutions in exchange for political liberalization concessions, this is likely to hasten the fall of the current system and the development of a more liberal society. To tighten the embargo, by contrast, will divide the Cuban communities, prolong State control, and extend the suffering of those who live in Cuba and those who care for them.

Thank you very much.

[The prepared statement follows:]

US House of Representatives

Committee on Ways and Means

Subcommittee on Trade

Testimony

June 30, 1995

by

Ana Julia Jatar

Senior Fellow

Inter-American Dialogue[1]

I am pleased to respond to the Committee's request for testimony concerning the "economic relationship between the United States and Cuba after Castro". I have organized my presentation in the following manner. First, I present my conclusions and their implication for US policy towards Cuba. In the following sections I analyze the recent economic and policy trends in Cuba in which I based my conclusions. Specifically a evaluate the implications of the major contraction of the Cuban economy after 1989, the reforms introduced by the government to deal with the crisis and the dynamics generated by those reforms.

Conclusions and policy implications

The Cuban economy seems to have touched bottom. GDP declines have slowed down. The economic reforms introduced so far and the drastic decline in output and imports suggest that the economy is ready for some sort of recovery. Foreign investment is increasing.

The reforms enacted so far do not respond to a coherent plan. Nevertheless, Cuba's piecemeal reforms have some similarities with a China-style strategy. It is opening up some sectors that it hopes will generate significant growth in exports and employment before it needs to reform other sectors. This strategy, which is in great contrast with the big-bang approach followed in Eastern Europe and the former Soviet Union, requires Cuba to manage the contradictions of a dual economy. One sector of the economy remains under Central Planning, while a market sector with a different set of prices develops next to it.

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[1] These are my views and not necessarily represent those of the Inter-American Dialogue. The Inter-American Dialogue's Cuba Task Force has recently been in Cuba gathering facts to produce a report which will be issued next September. The facts and ideas expressed in this testimony are the result of my research and of conversations with Cuban high government officials and academics in Cuba.

Under the big-bang approach, currency convertibility is established first, prices are freed throughout the economy, trade is liberalized and privatization proceeds as fast as possible. The Chinese approach is slower in terms of the speed of reform, both economic and political, but has allowed in China, a sustained period of double-digit growth. It also generates great inequalities and corruption.

An important question is whether Cuba will be able to restore growth and keep distortions between the two co-existing economic systems from ripping the society apart, through growing inequality, corruption, profiteering or plain economic success.

I believe that the succeeding analysis supports the following propositions:

First, the Cuban economy is not about to collapse and will not do so under the pressure of further sanctions. In fact, it is more likely to start a recovery after the major and inefficient decline in output and income which took place between 1989 and 1993.

Secondly, Cuban reforms have been lead by the force of reality and not by conviction. The Government is following a reactive, not pro-active stance. As reality impel civil society and the economy into illegal or unauthorized activities, the Government is forced to change the constitutional and legal framework, in order to permit the inevitable. This explains the legalization of holding of dollars, of farmers markets, of farmers cooperatives, of self-employment and of foreign ownership. The piecemeal economic reforms introduced so far are generating a market dynamic in some sectors which are slowly pushing further to new changes. If more markets are opened, the dynamics generated will force the government to make even more reforms.

Thirdly, the greater the market opportunities faced by Cubans, the more the contradictions and the faster they will leave the current State controlled system which remains under tight party control. Hence, the elimination of the US embargo is likely to accelerate the pace of reform and the development of a more autonomous sector in the economy.

Fourth, as the more market oriented and independent sectors of the economy develop, there will be a wider and more autonomous constituency in favor of liberal democracy.

Fifth, tightening the embargo and placing the emphasis on property claims will alienate important reform-minded sectors in Cuba and will strengthen the power of the Castro government. The last thing that any Cuban wants after wasting 36 years of their lives under a failed system, is to start a new era with a regressive reallocation of the few assets that still remain in the Island.

Finally, there clearly is an opportunity for a different policy. Suspending the embargo and inviting Cuba to the multilateral financial institutions in exchange for political liberalization concessions is likely to hasten the fall of the current system and the development of a more liberal society. To tighten the embargo by contrast, will divide the Cuban communities, prolong state control and extend the suffering of those who live in Cuba and those who care for them.

The crisis

Since 1989 the downfall of communism in the former Soviet Union in 1989, the Cuban economy has gone through a major contraction. Exports plunged from $5.4 billion in 1989 to $ 1.7 billion in 1993 due mainly to the collapse in sugar production which fell from 8 million tons in 1989 to 4 million tons in 1993[2]. GDP fell over 40% during the same period. Imports were brought down from $8.1 billion in 1989 to $2.2 billion and the trade deficit was kept low, in line with the meager external financing.

SELECTED CUBAN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994
GDP						
GDP(US $millions)*	19,177	18,602	16,611	14,684	12,482	12,569
% Change in GDP	0.3	-3.0	-10.7	-11.6	-15.0	0.7
GDP /capita (in $)	1,813	1,739	1,538	1,346	1,133	1,136
% Change	-0.7	-4,1	-11.6	-12.5	-15.8	0,2
Balance of Payments						
Exports(US$ millions)	5,392	4,910	3,585	2,210	1,755	1,700
Imports(US$	8,124	6,745	3,690	2,563	2,203	2,300
Trade Balance	-2,732	-1,835	-115	-353	-448	-600

Sources:
CEPAL Report, *Cuba: Evolucion Economica Durante 1994*
U.S. Trade and Economic Council
Ariel Terrero, *Tendencias de un Ajuste*, Bohemia (Oct 26 1994)
Cuban government officials.

The 1989-1992 insufficient adjustment

In order to face the massive contraction of export revenues, the Cuban government relied in a set of measures which generated important economic disequilibria and inefficiencies which at the same time are promoting further adjustments and reforms.

For example, the serious efforts oriented to attract foreign private capital in the tourist sector increased the circulation of dollars in the economy and the proliferation of the black market for goods. On the other hand, the original intention of just opening tourism to foreign investment was soon defeated by reality. When important export sectors like nickel, tobacco, citrus and biotechnology were lagging behind due to technology obsolescence and lack of hard currency to buy inputs, the government opened up these sectors to foreign investment. Only sugar, the traditional source for foreign exchange in Cuba, remains closed to direct foreign investment. Nevertheless, if it continues to show the poor performance to date, --in 1995 the sugar harvest plunged to

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[2] This shock was partly the result of the elimination of price subsidies on sugar and nickel by the USSR. Total subsidies to Cuba averaged US $ 2.100 million per year during the 1960-1990 period. Also, the collapse on sugar production was caused by the lack of access to imported inputs and the break-up of large, capital intensive state farms into smaller labor intensive cooperatives.

3.2 million tons, the worst performance in the country's history-- Cubans will have to leave behind misconceived notions of nationalism and accept private investment in sugar. In order to make these changes and private investment legally possible, Cuba's National Assembly passed in 1992, a number of amendments to the 1976 Constitution providing the legal basis for transferring state property to joint ventures with foreign partners[3].

Also the adjustment through foreign exchange rationing is generating important inefficiencies. In market economies, an adjustment to an external shock of this magnitude would have required a massive devaluation to reduce the demand for imports and increase the profitability of export and import-competing sectors so as to efficiently return to external balance. Such real devaluations require a lower real wage. The government was not prepared to pay the costs of a the adjustment. Thus, as a centrally planned economy, they reacted to the sudden shortage of foreign exchange not by devaluing, but by *rationing* foreign exchange and *administratively distributing* dollars to different sectors.

In spite of the objectives of the Cuban government, the use of this arbitrary process as a substitute for devaluation generates high inefficiencies and Cuba is paying the cost of them. On the one hand, since products are neither more expensive nor more profitable, --as it would have happened with devaluation-- shortages develop as output contracts and demand grows at the set low prices. In other words, the system does not generate the price incentives to produce or save dollars. Another result of this policy is that adjustment is even more painful than necessary since key export sectors contract dramatically due to the lack of foreign exchange to buy the imported inputs. This vicious circle undermines the generation of foreign exchange. For example, sugar and nickel, two traditionally important sources of foreign exchange suffered from a lack of imported inputs, including gasoline and fertilizers, which caused production bottlenecks and thus earned fewer dollars. In the case of sugar the situation has taken dramatic proportions..

Given the absence of sufficient market adjustment, Cubans were left with more purchasing power -- measured at the official prices- - than the actual supply of goods which they had available. This led to greater rationing and higher black market prices for goods.

Also insufficient adjustment led to a fiscal deficit that reached 40% of GDP in 1993.

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[3] They also abolished the State monopoly on foreign trade and relaxed the concept of central planing by changing the concept of *one plan* (plan unico) to that which "guaranties the programmed development of the country".

FISCAL AND MONETARY DATA (in millions of pesos)

	1989	1990	1991	1992	1993	1994
Fiscal Income	12,486	14,601	9,175	11,362	9,556	11,891
Fiscal Expenditure	13,886	16,706	12,332	16,162	14,567	13,297
Fiscal Deficit	-1,400	-2,105	-3,157	-4,800	-5,051	-1,406
Fiscal Def.%GDP	7.2	10.5	26.8	34.8	40.0	7.4

Sources:

CEPAL Report, *Cuba: Evolucion Economica Durante 1994*
U.S. Trade and Economic Council
Ariel Terrero, *Tendencias de un Ajuste*, Bohemia (Oct 26 1994)
Cuban government officials.

The government could not stop spending, while exports, the economy, and fiscal revenues were collapsing. Given the absence of external financing and of internal capital markets, the government had very little choice but to cover the deficit by printing money. As a consequence, the economy was flooded with liquidity. The number of pesos in circulation increased from 5 billion in 1990 to 11.4 billion in 1994. In a market economy, excess liquidity creates inflation. In a centrally planned economy the effects are different. Since official prices do not change and people have more money to spend than products to buy, huge shortages and black markets develop. By the end of 1993 the official exchange rate was 1 peso per US dollar, while it reached 150 pesos per dollar in the black market.

1993-1994: further adjustments

During 1993-1994 the Cuban government had to make new changes in order to deal with the consequences of their insufficient adjustment. Also, new reforms were announced in an attempt to solve the increasing contradictions between the new market-oriented sectors of the economy, where foreign investment was increasing, and the controlled, centrally planned, socialist economy. In other words, the system has now a dynamic of its own which forces the government to make more changes than originally planned. The reforms are generating contradictions with the traditional socialist system, this contradictions are resolved by the development of illegal market activities, which in turn force the government to create a new regulatory framework to legalize them. The following are some examples.

The legalization of hard currency

As a consequence of the reforms to attract tourism and foreign investment, the dollar economy began to expand, and black market activities boomed. Since these illegal transactions in dollars common practice among Cubans, the government did not have any other choice but to legalize dollar holdings. On July 26th 1993, Fidel Castro made the following historic statement: " today life, reality... forces us to do what we would have never done otherwise...we must make concessions." Among others, he made the following announcements: 1) Cubans would be permitted to have foreign currency and to buy directly in special stores; 2) the government would introduce a national currency which

would be convertible; (this commitment was made effective in December 1994); 3) bank accounts in dollars would become legal and 4) Cubans could pay for the services of other Cubans in dollars. The objectives of these measures were to eliminate the hard currency black market and to stimulate the dollar remittance from families abroad[4]. Different sources estimate dollar remittances from Cubans in exile to be in the vicinity of US $ 500 million even after the controls imposed by the US government.

Over seventy stores have been created to sell services and products which Cubans could buy in dollars. Cubans could have access to dollars through remittances from relatives in exile and through those who have linkages with the external sector (tourism and foreign ventures). Soon inequalities resulted among those who had access to dollars and those who only had access to pesos

Self employment

At the end of 1993, the Government allowed self-employment in about 100 occupations[5], and since December 1994 artisan markets were created in order to allow the selling of a variety of "light manufactures" and artisan goods. Cubans can charge in pesos or dollars for these goods or services. Some professions such as health services were excluded because they are intensive in a form of human capital --nurses and doctors-- which were originally provided by the State. The decree originally also excluded home restaurants, nevertheless due to the spread of illegal home restaurants the government decided to formalize its existence in June 1995 and hundreds of home-restaurants became legal.

To register for self-employment the applicants must be: a) employees in the state sector, b) displaced state workers receiving unemployment compensation, c) pensioners, d) disabled and e) housewives. According to different sources there were between 110,000 and 160,000 self-employed by December 1994. Pedro Ross, President of the Cuban Workers Union said that 500,000 out of the 2.2 million people employed by public enterprises could be "pushed out of their jobs and encouraged to become self-employed." Also around 80.000 Cubans who join the labor force every year will consider self employment as an option.

The self-employed have not yet been allowed to hire other workers, since wage labor remains prohibited, except in public and foreign-owned companies. In practice, hiring is taking place illegally in restaurants and in other small businesses.

The development of a market for the self-employed is encouraging other illegalities Growth in the self-employed sector is also limited by a restricted access to inputs given that these are controlled by the State and are not readily available. Mechanics, plumbers and artisans have little choice but to get inputs illegally from a growing black market

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[4] In August 1994, the US government prohibited these cash flows to Cuba as a response to the increase in illegal immigration.

[5] Among others: hairdressers, plumbers, carpenters, electricians, taxi drivers, barbers, tailors, cooks, shoemakers, baby-sitters.

where supplies are usually stolen from state companies. The government has also little choice but to silently allow it. This situation will continue until Cuba eliminates its greatly distorted exchange rate regime.

Reforms in agriculture

There have been two main reforms in the agricultural sector. First, in 1993 the government began a process of cooperativization of the land by breaking-up large state farms into Basic Cooperatives of Production (Unidades Basicas de Producción Cooperativa). These cooperatives have the right to use the land, have ownership of the crop, own bank accounts, and freely elect their own management. According to some IMF and ECLAC estimates, by the end of 1994, between 70 and 75 percent of the farming land was in the hands of cooperatives. The second reform was designed to authorize cooperatives and individual farmers to sell at market prices, the excess of output over the established quota.

Individual farmers and cooperatives can sell their products, in each of the 169 municipalities, in markets established for that purpose since October 1994. They are called farmers' markets, and goods are sold at prices determined by supply and demand.

To be allowed to offer their products in farmers' markets, producers must have satisfied their pre-set quota -around 80% of their output- and must pay taxes.

By far the most liberalized sector of the Cuban economy is the agricultural sector. As in the case of China, farmers are becoming an affluent group in society. According to some estimates, their savings represent 75% of the total private savings. Farmers are increasingly asking for more freedom and less government intervention. They are particularly unhappy with the prices set by government for the quota. By June 1995, the prices paid by the government were approximately 1/35 of those set by supply and demand in the free markets.

Fiscal reforms

The fiscal deficit was reduced from 40% of GDP in 1993 to 7% of GDP in 1994. In order to achieve this result, the government had to widen its sources of income and at the same time reduce subsidies and salaries.

On the *income side,* taxes were increased by 24%. A new income tax was imposed on the self-employed, farmers and cooperativists. There was an important increase in prices in some goods and services such as tobacco, liquor, electricity[6], transportation, gas and mail services, among others.

On the expenditures side there was a reduction of 9%. A major cut in the size of the central government, 15 ministries were eliminated and different subsidies in education

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[6] 94% of Cuban households have electricity. The price increase has only affected 50% of the households for amounts consumed in excess of 100 kw per month.

and health were reduced. A social security contribution of up to 12 percent of wages was introduced in early 1995 to pay for the country's onerous pensions.

In spite their inmendiate sucess, these reforms are not enough, there is an agreement among some high Cuban government officials that a more comprehensive tax reform is needed in the future. It is obvious that the political viability of this policy will depend on the development of a profitable private sector.

Exchange rate and monetary reforms

There are two parallel economies operating in Cuba with two currencies and two markets: the dollar economy and the peso economy. The dollar has been circulating legally since June 1993 and it is estimated that currently almost 25% of the population has access to dollars. The peso, which still has an official value of one peso per dollar, has been traded in the un-official market at different prices reaching up to 150 pesos per dollar in 1993. During 1994 the peso appreciated very significantly to the still very high level of around 35 pesos per dollar. By June 1995 it had maintain the same value. This reflects mainly the contraction in the money supply which took place in 1994, thanks to improvements in the fiscal accounts and other measures.

By the end of 1994 the *convertible peso* was created in order to begin a process of unification of exchange rates and to replace the dollar and other foreign currencies. There is no evidence unification so far. Probably this will remain unclear until the government accepts the need for a devaluation of the traditional peso, which by June 1995 was being trade in the informal markets, at 35 times its official value. Nevertheless, the government has announced that in some activities such as tourism, workers will be paid in convertible pesos in order to incentive its use. Also it announced the use of convertible pesos at the special state outlets created for the dollar market. The new convertible peso has kept its exchange rate fixed at 1 peso to the dollar, and no significant black market has appeared for it.

Foreign investment

Different sources suggest that foreign investment agreements for around 2 billion US dollars -up to the year 2005- have been signed between the Cuban government and over 15 countries such as Australia, Canada, France, Germany, Great Britain, Israel, Italy, Mexico and Spain among others. Originally Government intentions were oriented to attract foreign investment only in tourism. Soon reality forced them to open other sector to private capital in the search for new technologies and hard currency. The most popular sectors besides tourism, are: agriculture (mainly tobacco and citrus), mining (nickel, lead, gold and chrome) oil and coal, telecommunications and textiles.

Cuba has signed investment protection agreements with most of these countries guaranteeing equal treatment, abstention from nationalization and the right to repatriate profits and capital. With the objective of attracting more private capital, the new foreign investment law is expected to allow 100% private ownership.

1994 results

The Cuban economy stopped contracting during 1994. According to the Cuban government it even revealed a slight recovery of 0.7 percent GDP growth. In that year the fiscal deficit dropped dramatically from 40 to 7 percent of GDP, while the exchange rate in the black market appreciated from 150 to 35 pesos per dollar[7]. Foreign investment increased and by 1995 there were agreements signed with different countries for investment projects up to 2.0 billion dollars until the year 2005.

It seems that the economy has adjusted to a lower level of activity. GNP has stopped contracting thanks to the expansion in new activities such as tourism, mining, oil, and non-sugar manufacturing. Foreign investment has also been growing in these new activities.

Percentage Growth Rate in Selected Sectors

	1993	1994
Traditional		
Sugar	-40.1	-4.8
nickel	-32.9	-9.6
Non-Traditional		
Tourism	25.3	15.2
Non-Sugar Manufactures		9.2
Construction		8.1
Oil	22.2	18.2
Mining**		10.2

* For 1994 only 45% of installed capacity was used

** Copper, gas and zeolite.

Source: *Cuba Evolucion Economica durante 1994.* CEPAL, 1995.

According to the 1994 ECLAC report, 18 industrial sectors grew during the 1993-94 period. For the first time, tourism displaced sugar as the major source of foreign exchange providing US $ 800 million for 1994 which represented 35% of Cuba's total dollar revenue. The sugar industry only generated US $ 700 million.

In evaluating the adjustment and possible recovery of the Cuban economy after 1994, some important issues must be kept in mind to asses the real dimensions of the efforts ahead. The economy has experienced a dramatic contraction in a very short period and growth rates, though high in some sectors, do not necessarily mean rapid recovery.

For example, in order to recover the standard of living of the average Cuban in 1988, the economy will have to grow for eight years in a row at a rate of seven percent.

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[7] Albeit the peso appreciation, the discrepancies between the non official and official exchange (one peso per dollar) is very large and generates huge distortions in the economy. For example, the price of rice and beans in the free market is 9 and 8 pesos per pound respectively, while it is only 0.24 and 0.30 pesos per pound in the official market, a price differential which is in line with the exchange rate differential.

To substitute the foreign exchange earnings from sugar and nickel that it had in the 1980s, tourism would have to grow from 600,000 to about 3 million tourists per year. Over one billion dollars more in foreign investment would be needed to boost tourism to those levels. Hence, while the economy has stopped contracting, it has done so at a very low level of income which will take a long time to reverse.

Mr. SHAW. Thank you, Doctor.
Mr. Smith.

STATEMENT OF WAYNE S. SMITH, SENIOR FELLOW, THE CENTER FOR INTERNATIONAL POLICY

Mr. SMITH. Thank you, Mr. Chairman. It is a pleasure to be here today.

As I say in my statement, I think discussion of how we construct a commercial relationship in a post-Castro Cuba is decidedly premature, because like the previous speaker, I see no signs of collapse in Cuba at all, and I think a post-Castro period in Cuba is years away, perhaps as much as a decade.

And I totally reject the idea that the embargo is only 3 years old. The prohibition on subsidiary trade imposed or reimposed by the Cuban Democracy Act in 1992, in fact, had been in force from 1961 until 1975, and it had not done the slightest bit of good. We raised it in 1975 because of our conclusion that it caused us more problems than it did Castro.

It was reimposed in 1992. Congressman Torricelli assured us in December 1992 that because of the Cuban Democracy Act, the Castro regime would be gone within weeks. Well, almost 3 years have gone by. Not only has the Castro regime not disappeared, but the Cuban economy is now beginning to recuperate, as the previous speaker has indicated. The freefall is over. They had a small rate of growth last year; it will be more this year, because of changes.

There will be no collapse in Cuba, but there must be change, principally—yes, Cuba is in an economic crisis—principally because of the collapse of the Soviet Union.

I am totally puzzled by the testimony of some of the previous speakers who say on the one hand that the American embargo is not responsible for Cuba's economic distress, that that distress stems from the collapse of the Soviet Union and economic mismanagement, but then in the next breath say that our embargo is having an impact on Cuba and it is forcing Cuba to modify its economic practices, to change its system.

I would agree with those who say that, in fact, our embargo has very little to do with the changes being made in Cuba. Those changes come about because of Cuba's economic crisis resulting from the collapse of the Soviet Union and Cuba's loss of a preferential trading relationship with it.

Because of that, Cuba must reform; it must move toward a mixed economy and is doing so. It is not simply foreign investment; it is not simply a new foreign investment law.

There are now some 200,000 Cubans self-employed under the self-employment law.

A small business law has been circulated and will soon be promulgated, allowing for the establishment of small private businesses in Cuba. When you have more than 1 million Cubans involved in small businesses, making it on their own, that creates the dynamic for political change. So we already have economic change, and political change will come in its wake.

And Cuba is not isolated. We speak of increasing Cuba's isolation. Cuba has diplomatic relations with 150 countries. It is a full member of the United Nations. If anyone is isolated, it is us on our

Cuban policy. The vote in the United Nations last year was 101 to 2 against our embargo. The only country to vote with us was Israel, and it trades with Cuba. No one agrees with our policy.

And not only the present policy; even less do they agree with the so-called Helms-Burton bill. The European Community, the Canadians, the Rio Group, the CARICOM countries—that is, the Caribbean nations—the Mexicans, human rights activists in Cuba, the Cuban Catholic bishops—Eloy Gutierrez Menoyo, we saw in the Washington Post yesterday, leader of a moderate group in Miami—all oppose the Helms-Burton bill and all tell us that our policy is wrong, that we should shift; we should move toward engagement.

What should we do? Perhaps not lift the embargo entirely. That may not be politically feasible. But I would suggest that at the very least the United States lift the prohibition on the sale of foods and medicines, which never should have been included in the embargo in the first place.

The OAS has already indicated or reminded us that inclusion of foods and medicines in a trade embargo is a violation of international law. We should remove foods and medicines.

We should lift travel controls, which are unconstitutional. And you do not encourage a more open system by trying to keep Americans from traveling there.

Having done those things, then we indicate to the Cubans, we have taken these steps; we are prepared to engage. But the pace at which we move forward will depend on how they move ahead with their internal reforms.

In other words—and I conclude with this, Mr. Chairman—in other words, make it clear that there is a causal relationship between positive steps on the Cuban side and U.S. responses.

Thank you.

[The prepared statement follows:]

Statement of Wayne S. Smith
Before the Subcommittee on Trade
of the
House Committee on Ways and Means

June 30, 1995

Mr. Chairman, members of the committee, I appreciate the opportunity to appear before you today. I believe it best, however, to make my position clear from the outset. We are here, according to the program, to discuss the economic relationship between the United States and Cuba after Castro. But it seems to me, and I believe to most observers, that such a discussion is decidedly premature, for the the post-Castro period is still years, perhaps even a decade, in the future.

I say "to most observers" because what seems to be conventional wisdom in the U.S. as to what is going to happen in Cuba over the next few months and years is as isolated as is U.S. policy. Not a single other government in the world supports that policy, nor will they be persuaded to support it or cooperate with it in the future. Nor do most observers in the world believe the Castro government is on the verge of collapse. It is going through an economic crisis, yes, resulting largely from the loss of its preferential trading relationship with the former socialist republics. But collapse? Not at all. Congressman Robert Torricelli of course assured us in 1992, when his Cuban Democracy Act (CDA) was passed, that the Castro government would be gone within weeks. Not only is it still there, but the Cuban economy, despite the CDA, has begun to recuperate. Last year it registered a very slight growth -- .7%; This year the growth rate may be up to 2%. Not much, to be sure, and they have a long way to go to recover from the 50% retraction suffered since 1991. Still, the corner has been turned. The system has survived the worst. It certainly isn't going to collapse now that recovery has begun.

To be sure, recovery has begun only because of the reforms initiated by the Cuban government. Much more needs to be done, but the process has begun and there is now no turning back. The reforms are <u>not reversible.</u> Cuba must abandon the centralized, state-dominated economy and move toward one that is thoroughly mixed, with a broad private sector, private investment and enterprise. It is doing so. Not as rapidly as it should, perhaps, and not because it wishes to move in that direction, but because it really has no choice.

As a result, one notes a dramatic change from the summer of

1994. Then indeed there was a certain desperation among the Cuban people and a sense that the government was not going to make the necessary changes. Food was short and there were long blackouts. Then, in September, came the decree authorizing farmer's markets. Within months, foodstuff was available again. Prices remained high, but began to come down. The cost of rice, for example, fell from close to 60 pesos per pound in September to 6-10 pesos in February. The price of beans dropped from close to 70 pesos per pound in September to 13 pesos. Other food prices dropped in the same way. The price of the dollar also fell, from a high of 125 pesos to the dollar in September, to around 45 pesos today. That is a fair reflection of the economy's recovery.

With state farms now turned into loose cooperatives, user titles to the land being passed out to those who till it, more and more farmers are joing the ranks of the some 175,000 small private farmers left in place by the Revolution. At this point, it is fair to say, the agricultural sector is moving toward privatization. The sooner it gets there, the better. No socialist agricultural system was ever successful and the Cuban model was no exception.

Free artisan markets have also been opened and the self-employment law expanded to permit the hiring of employees in specified enterprises. Again, the Cuban government had little choice. Those who run private restaurants, repair shops, laundries and tailor shops were already employing other people. Indeed, it is estimated that more than 200,000 Cubans are already self-employed are privately employed -- in addition to private farmers. That number will soon expand dramatically for a new small-business law is shortly to be promulgated under which groups of Cubans can pool their resources and open small businesses. As many as 800,000 Cubans are expected to do so. Why is the government doing this? Because it has no choice. It cannot keep open factories that are operating at 25% productivity; cannot continue on with state enterprises that are not profitable. Rather, in order to rationalize the state sector and put it on a paying basis, it must lay off thousands of people -- perhaps as many as a million. The only way to absorb most of those newly unemployed will be through a dramatic increase in the private sector. And thus the small business law.

But whatever the cause, the result will be the same: the growth of the private sector; the creation of private enterprises in Cuba. And we are speaking here of Cuban enterprises. As we all know, private <u>foreign</u> investment was already permitted and has been growing dramatically over the past two years. Here again, however, new developments are in the offing. A new Foreign Investment Law has been circulated and

will be promulgated shortly. This provides far more flexible guidelines for foreign investment, even moving from the traditional 50/50 ownership to 100% foreign ownership under certain conditions.

Dozens of foreign firms have already opened offices in Havana. More are doing so every month. There seems to be some expectation in the halls of Congress that the so-called Helms/Burton bill will change that. It will not. If there is anything taught by business schools in the United States, it is that where there is a profit to be made, there will be those to take advantage of it. There are profits to be made in Cuba and private foreign firms will not desist from pursuing them because the United States wishes them to do so. Some companies might pull out, but there will always be others to take their place.

Political changes are coming far more slowly. Religious freedoms have been greatly expanded. An inchoate electoral system is in place that may some day lead to open elections for the National Assembly. At present, with only one candidate for each seat, what one really has is a plebiscite, not an election. Even that is an advance, however. Three years ago, there were no popular elections at all for the National Assembly.

There is also now far more room to debate ideas and to argue for change. Limited internal dialogue is possible. The recent return of Eloy Gutierrez Menoyo, the leader of a guerrilla force against Castro in the early sixties who spent 22 years in Castro's prisons, is, hopefully, a signal that a meaningful dialogue can begin between the Cuban government and Cubans abroad. Menoyo was released from prison in 1986 and departed the country declared a traitor. That he was allowed to return and sit down for a long and frank conversation with Castro is a positive sign, though only time will tell how positive.

But however slowly political change is occuring, the dynamics for evolution are there. Cuba needs to be fully reintegrated into the international community -- and especially the hemispheric community. In order to do that, it must open up its politica system. Cuban leaders understand that. Further, soon there will be well over a million Cubans making it on their own economically -- not receiving government pay checks but operating as private entrepreneurs. That in itself will increase the pressures for political change.

Most Cubans want change, political as well as economic, but there is little consensus as to what they want to see as the outcome. Everyone wants enough to eat, decent housing, plenty of electricity and a an all-round higher standard of living. Virtually everyone wants a more relaxed political system, but

there the consensus ends. The only poll we have available -- one conducted by Gallup at the behest of The Miami Herald -- suggests that most Cubans blame their government much less than one would expect for present difficulties and that the majority continue to support the government (with or without enthusiasm). Conversations American visitors have had with a wide range of Cubans suggest also that while many think the pace of change is perhaps too slow, they nonetheless express agreement with the idea that it be carefully controlled, that it not get out of hand and lead to the kind of chaos and even criminality seen in the former Soviet Union.

It is probably largely because of their wish to avoid chaos that many Cubans continue to accept the leadership of Fidel Castro. There is more questioning of his authority than before, and certainly more grumbling, but most Cubans seem to feel there is still a need for him. Perhaps in part it is that they cannot quite imagine life without him. He has, after all, dominated, the political landscape for the past forty years. But there is also clearly the calculation that he is the only one with sufficient authority to lead the nation through its present crisis and toward a different future. Many compare the present Cuban transitional period to an earlier one in Spain under Franco, another authoritarian Galician. Castro, as they see it, will begin the process of change and guarantee that it be a peaceful one. Then, years in the future, as the process is well advanced, will be time enough to think of him stepping down.

Whether Castro still has the support of the majority is difficult if not impossible to say -- in the absence of a really accurate poll. Clearly, however, he has the support of a much greater percentage of the population than acknowledged on Calle Ocho in Miami. Even if he did not, there is no organized opposition and not likely to be any. Cuban security forces are massive, well-trained and loyal to Castro. All the power factors are in Castro's favor. Now with a recovering economy, there is no reason at all to conclude that his government will soon collapse. Indeed, that would appear to be little more than wishful thinking.

And what, then, should be the role of the United States? Clearly, we should want to see a more open economy and political system, greater respect for human rights and for the civil liberties of the Cuban people. At the same time, it is in everyone's interests, in ours and certainly in the Cuban people's, to see this come about as the result of a peaceful transitional process. Bloodshed is the last thing the Cuban people want. A bloody upheaval that would result in tens of thousands of refugees on our shores is the last thing we should want. Yet, a U.S. policy of trying to isolate Cuba, of maintaining an embargo that includes even the sale of foods and medicines, and of trying to expedite the end of the Castro

government, risks exactly such an outcome. Senator Helms has said that the purpose of the legislation he has introduced in the Senate is to carry Castro out feet-first or vertically. How he intends to accomplish that without inciting a full-scale civil war, i.e., the bloody upheaval we shouldn't want, he has not explained.

U.S. policy at this time is illogical and counterproductive. The Helms/Burton bill, if passed, would make it even more so. What should we do? Clearly, move in the other direction. The Cold War is over and a slow process of change has begun in Cuba -- a process that over time will transform it into a very different kind of society, one with a thoroughly mixed economy and a more democratic political system. Seven, eight, ten years from now, we will probably describe Cuba as a social-democracy. We could do far more to encourage that change, and even accelerate it, through reduction of tensions and gradual engagement. While a total lifting of the embargo would be desirable, it is probably not political feasible at this time. The Administration, with the support of Congress, should, however, lift all travel controls. They are unconstitutional and will soon be removed by the courts anyway. Further, Cuba's religious leaders and human rights activists, the very people we say we want to help, urge us to lift those controls, arguing that the more American citizens in the streets of Cuban citizens, the better for the cause of a more open society. Their logic is unassailable.

We should also close TV Marti, which is never seen nor heard and is a waste of the taxpayers money -- and will be no less so after it switches over to the new UHF system of transmission.

We should also lift the embargo on the sale of foods and medicines. Inclusion of those items in a trade embargo is in conflict with international law, as the Organization of American States has now pointed out to us. The CDA does not effectively exempt medicines and food stuffs are not exempt at all. As a humanitarian gesture, we should remove them.

Then, having taken those steps, we should indicate to the Cubans that we understand the Cold War is over and we are prepared to have a new relationship with them. The pace at which we move ahead to that new relationship, however, will in large part be determined by how energetically they move forward, in their own interests, with internal reforms leading to a more open economy and political system. Meanwhile, we should say, we are prepared to negotiate with them a number of bilateral issues standing in the way of improving relations. First and foremost on our side would be the issue of compensation for properties taken from American citizens and companies back in the early sixties. These were long ago registerd with the U.S. Claims

Commission and the Cuban government has for at least 20 years now recognized its obligation under international law to compensate those property owners and indicated its willingness to negotiate a compensation agreement with the United States. It remains willing to do that. Cuba, however, does not have the money to pay. Hence, a compensation agreement would doubtless have to be tied to a lifting of the embargo and some financial scheme to create a fund out of which the claims would be paid -- such as a surcharge on Cuban exports, or a departure tax on U.S. tourists.

That is entirely doable now. If the Helms/Burton bill passes, it will not be, for the latter, incredibly, will add the claims of Cuban-American property owners,i.e., those who were not U.S. citizens at the time they lost their property, to those of the original American claims. This is in conflict with both international law and all past U.S. practice. The result will be that no one will be compensated, for the Cuban government will simply take the position that as there is no basis in international law for all these claims, it is under no obligation to pay any. This does a tremendous disservice to the original American claimants, at the same time that it advances the prospects of Cuban-Americans claimants not at all.

Whatever the United States does, whether it passes the Helms/Burton bill or not, Cuba will survive and the reform process will move ahead. Even if the United States does not begin to engage now, years from now, it will have to accept the inevitable and normalize relations with Cuba. Meanwhile, however, it will have played no role in or even impeded the transitional process in Cuba, and American businessmen will be prevented from competing with their French, Canadian and British colleagues. Our policy, in effect, harms us more than it does Cuba. But, then, we have never had an intelligent policy toward Cuba, not in the last sixty years. So why begin now?

Mr. SHAW. Thank you, Mr. Smith.
Mr. Rogers.

STATEMENT OF WILLIAM D. ROGERS, SENIOR PARTNER, ARNOLD & PORTER AND VICE CHAIRMAN, KISSINGER ASSOCIATES, INC.

Mr. ROGERS. Mr. Chairman, I have submitted my statement for the record. It does not address the raging debate over present U.S. policy and the continuation of the embargo. I have had my say on that issue in other fora.

The statement addresses what I take to be the central topic of the hearing today, and that is U.S. economic relations with Cuba, post-Castro era.

What I have to say is, if you will, on the rather sober side. It differs from what have been, I think, the rather romantic statements about the possibility that Cuba will blossom into a full-fledged modern economy the minute Fidel Castro disappears.

I differ with that view from a macroeconomic standpoint. I think the end of communism in Cuba will be only the beginning of a very painful process of reform and restructuring which must take place if Cuba is to regain the path of economic growth.

The present Cuban economy, as we all know, is a wreck. If a 40 percent decline in GDP is not a collapse, I do not know what is. The fact of the matter is that even under the glory days of the Russian subsidy of $3 or $4 billion a year, Cuba was, at best, able to import about 8 billion dollars' worth in 1989. At the present time, according to Fidel Castro's own figures, its import capability is about $2 billion. The possibilities of that increasing, of course, depend on Cuba's capacity to export, a post-Castro Cuba's capacity to export.

Sugar is no high road to export earnings. In the best of times, Cuba occupied about 38 percent of the sweetener market in the United States, which at the time, in the late fifties, was almost entirely cane sugar.

At the present time, corn syrup has very largely replaced about half of cane sugar in the U.S. sweetener market, and foreign imports of cane sugar constitute less than 10 percent of the entire sweetener market in this country.

To shove Mexico and Brazil, major exporters of cane sugar to the United States, to one side will, as Deputy Secretary Casey said, itself have grave consequences for the foreign policy of the United States.

Furthermore, on the other hand, Cuba faces major competition. The rest of Latin America has moved rapidly in the last 10 years down the path of reform, fundamental reform in the restructuring of their economies by the elimination of public sector deficits, the establishment of sensible exchange rates, privatization of industries, deregulation, and a host of other policies which are essential for any nation to compete in the globalized world economy of today.

Cuba, post-Castro, must go down that path, and it will be going down that path far behind its potential competitors in Latin America. This will be particularly so because the other competitors in Latin America will be, over the next several years, we hope, acceding to NAFTA, and in doing so, they will be required to adopt a

variety of reform measures which will be essential for eligibility for NAFTA accession.

Cuba, in order to gain competitive equality with those other nations by entering NAFTA, will also itself have to undertake those policy reforms.

World capital markets, Mr. Chairman, are essentially un- sentimental at the present time. World capital markets, as we have seen in the case of Mexico, will go where the investment climate is best.

Cuba, post-Castro, under the best of circumstances has a long way to go and a painful adjustment process before it puts itself on a plane of competitive equality with its neighbors elsewhere in the hemisphere.

Thank you very much.

[The prepared statement follows:]

TESTIMONY OF WILLIAM D. ROGERS
TO THE SUBCOMMITTEE ON TRADE
OF THE COMMITTEE OF WAYS AND MEANS
HOUSE OF REPRESENTATIVES

JUNE 30, 1995

Committee Hearing Room 1100
Longworth House Office Building

Mr. Chairman, members of the Committee, it is a pleasure to appear before you today. I am, as you may know, a senior partner of the law firm of Arnold & Porter and Vice Chairman of Kissinger Associates, Inc., but I appear here in my private capacity. My views are my own. They reflect a long interest in Cuba and its role in the Hemisphere, which began during my stint as Assistant Secretary of State for Inter-American Affairs and later as and Under Secretary of State for Economic Affairs in the Ford Administration.

It is my understanding that the focus of the hearing is the economic relationship likely to emerge with Cuba after the fall of Communism in Cuba.

My view is not romantic.

I do not believe that it has been the US embargo which has wrecked the Cuban economy. Nor do I believe that the end of the Castro era and the presumptive dismantling of the US embargo will be enough to spark a magical revival of the Cuban economy. It would be wrong, I think, to suggest to the Cuban people that prosperity will flourish the moment Cuba rids itself of the yoke of Communism. Post-Castro Cuba will not emerge immediately and full-blown as a dynamic, rapidly growing, capital-importing economy able to make its way in the global competition. Quite the contrary. The end of Communism will be only the beginning of a long and painfully difficult process of economic adjustment for Cuba. Wrenching changes will be required.

The Cuban economy is a wreck. In its best days, perhaps five years ago, it could only stagger ahead with a $4 billion Soviet subsidy. That subsidy has come to a screeching halt. The result, according to figures announced by Fidel himself a couple of years ago, is that Cuba, which was able to buy imports at an $8.1 billion level in 1989, could finance only $1.7 billion of foreign goods and services in 1993 -- an 80% reduction in import capability, as the CIA characterizes it.

The overall economy is down by about 40% according to most calculations.

To get Cuba on its feet will be no easy task. Any effort to define the future economic relationship of the island with the United States must take these blunt realities into account.

Cuba's comparative <u>economic advantages</u> are not impressive, in the global scale of things:

1. It can grow sugar efficiently, but sugar is not in short supply in world markets today and the price is not strong compared with Cuba's production costs. Cuba at one time, before the revolution, had 38% of the

US sugar market; today, cane sugar has been replaced by corn syrup in half the US sweetener market, and imports, most of which come from Mexico and Brazil, account for only 10% of the US consumption of sweeteners -- a vast change from the glory days of Cuba's dominance of the US market. Cuba depends on sugar for over half its present export earnings. Citrus, fish and minerals, particularly nickel, have promising prospects in Cuba. But commodity exporting is not the high road to success in the global economy today, as the rest of Latin America has learned.

2. Cuba is ideally suited and sited for tourism, close to the United States with marvelous beaches. But so is the rest of the Caribbean. Mexico's own facilities in Cancun and the Yucatan Peninsula will be tough competition for Cuba. And a fair proportion of the tourism a post-Castro Cuba could attract would be tourism diverted from its Caribbean neighbors.

Set alongside these comparative advantages are some daunting <u>difficulties:</u>

1. Modern economies require expensive infrastructure. Energy sources, telecommunications systems, roads, ports, airports -- all are vital if a country is to succeed in the world competitive struggle. Cuba's infrastructure scarcely achieved world-class standards during the best years of the Castro regime and it has deteriorated remarkably since then. The woefully inadequate infrastructure of Cuba will be a detriment to investment for years to come, and the investment capital required to modernize it will be monumental.

2. Cuba's neighbors in Latin America have in the decade of the Nineties undergone remarkable growth and modernization. This occurred in Latin America as a result of the well nigh universal switch to sound macroeconomic policies -- elimination of public sector deficits, sound public finance, privatization of the state-owned enterprises which were albatrosses around the necks of the Latin American economies, infrastructure investment, modernization of securities and financial markets and overwhelmingly the opening of the economies of Latin America to foreign investment and competitive foreign trade. These policies have transformed the economies of Mexico, Brazil, Argentina, Colombia, Peru and Chile and made them world-class competitors.

Cuba is far, far behind. It will have no alternative but to follow the path blazed by its large, successful neighbors.

And it should be noted that those neighbors are by then reform efforts making themselves eligible for inclusion in NAFTA. This represents a considerable prize, in that it will establish preferential duty free access to the US market -- and therefore a measurable disadvantage for a post-Castro Cuba compared to the other Latins, at least until such time as it is able to manage the across-the-board reforms which are required for NAFTA eligibility.

The pain of such a revolution in the economic sphere should not be underestimated. If Cuba is to attract its fair share of the finite global savings pool in competition with the fast growing Latin states, it will have to offer a sound investment climate. This

means throwing open to foreign investors a full range of investment opportunities in the Cuban economy, dismantling existing tariffs and quotas and reorienting the Cuban economy to export -- and export opportunities as I have suggested are limited in Cuba today.

Post Castro Cuba must, in particular, establish a rule of law to govern an economy based on private contract, as opposed to the diktat of the state. Private property protection must be embedded in legal concrete -- and private ownership of the means of production will not be easy for Cuba to get its collective mind around after a third of a century of Castro socialism.

The experience of the rest of Latin America, however, and of the emerging economies of Asia and the former Soviet Union, has demonstrated that growth depends on sound public policy. In this respect Cuba will be writing on a clean slate. It has only to look to the experience of Russia and the other states of the former Soviet Union, and to Hungary, Rumania, Bulgaria, Czechoslovakia and Poland to know how complex and agonizing it is to replace a command economy with the free market.

But Cuba's developmental future depends on it. World capital markets are unsentimental. Capital and entrepreneurship will flow to the state that provides the most security, the best macroeconomic balance and the firmest assurance of a rule of law.

3. Investment flows from the United States, in particular, will moreover be contingent on resolution of the outstanding US claims for restitution or compensation for expropriated properties. This is a special impediment to future US-Cuban economic ties. In 1964, the claims were valued at $1.8 billion, but this number, of course, included only claims by then US citizens, and did not consider interest. If interest were added on top, and if as has been proposed in Helms-Burton the claims of Cubans who have become US citizens since are included, the amount reaches levels laughably beyond the capacity of the Cuban economy to service in the foreseeable future.

4. This does not suggest a very happy prospect for US exports to a post-Castro Cuba. Cuba needs and will need an enormous range of imports, but the prospects for financing those imports in the post-Castro period are not encouraging. Cuba's present export earnings are low, and there is little immediate prospect, even with a dismantling of the US embargo, for much increase in import capacity.

5. What are the prospects for concessional financing to fill the gap for needed imports? To my mind, they are not very encouraging. It is conceivable that, as Ernest Preeg has estimated, personal remittances might reach $800 million per year -- up from less than half that at the peak prior to the ban of last year. But this does not do much to close the gap caused by the loss of the $4 billion Soviet subsidy. The Cuban exile community in the US can scarcely take up all the slack left by the disappearance of the Soviet Union.

As to concessional official aid, the demands elsewhere in the Caribbean, particularly in Haiti, are high and the enthusiasm for bilateral assistance low in

this country at the present time. Finance by the development banks will be, and should be, contingent upon the adoption of the macroeconomic reforms I have mentioned earlier. As the republics of the former Soviet Union have discovered, there is many a slip between the cup of aid promises and the lip of disbursements when it comes to international financial institution assistance to post-Communist transformations.

All in all, then, my view is that the end of Castro is only the beginning of another struggle, a happier one of course but nonetheless a struggle, a struggle for total, sweeping reform. If Cuba lags in the reform process, its economy will stagnate, and the opportunities then for US trade and investment will be unimpressive; if, on the other hand, Cuba quickly moves down the path marked out by its Latin American neighbors in the last five years, it can over time become like them a successful emerging economy, with significant ties to the United States, one member of an increasingly prosperous, competitive trading community in this Hemisphere.

Chairman CRANE [presiding]. Mr. Rangel.

Mr. RANGEL. Thank you.

Mr. Sweeney, you have given an excellent statement on what we should do after Castro, as was directed by the committee.

Can any of these things be done before Castro falls?

Mr. SWEENEY. I think the answer to that might be yes, if Castro was showing any willingness or indication that he would undertake these sorts of reforms. But I do not see anywhere on the record, publicly or privately, in English or Spanish, that Castro has said he would do so.

Quite to the contrary. In interview after interview that I have picked up from different sources all over Latin America, Castro again and again reiterates his determination to not change the way he has been going. He will not change what he is doing. He insists again and again that he will never change.

So my answer would be no; I do not see it happening with Mr. Castro still in power.

Mr. RANGEL. What is the Heritage Foundation's position as relates to trade with communist China?

Mr. SWEENEY. Well, the Heritage Foundation's position with China, that comes up again and again when the issue of Cuba is raised. People are always trying to make comparisons between China and Cuba.

Mr. RANGEL. Those are bad comparisons?

Mr. SWEENEY. I think it is a rhetorical red herring.

Mr. RANGEL. I just want to know what its position is.

Mr. SWEENEY. Well, we think that China is much farther down the road toward reform.

Mr. RANGEL. I have no problem with it. Do you support trade with——

Mr. SWEENEY. Yes, I do, with China. Yes.

Mr. RANGEL. And did you support exportation of wheat to the Soviet Union?

Mr. SWEENEY. I cannot answer that question, because I do not specialize in Eastern Europe.

Mr. RANGEL. Well, forget that. You are an expert anyway.

Do you believe that the United States of America should have exported wheat to the communist Soviet Union? We did it.

Mr. SWEENEY. I specialize in the Western Hemisphere, sir. I do not—I cannot answer that question.

Mr. RANGEL. Do you believe that we should trade with any communist nation that is not moving forward and displaying a movement toward free democracy?

Mr. SWEENEY. I believe that that is something that has to be looked at on a case-by-case basis. I think in the case of China, it is demonstrated that China is moving in the right direction. In the case of Cuba, I do not see that.

Mr. RANGEL. Can you think of any country besides Cuba that we have ever had a policy like this where we determine their movement toward democracy, as we see it, as a reason to trade or not trade with them?

Mr. SWEENEY. I beg your pardon?

Mr. RANGEL. Is there any other country besides Cuba that we relied on a movement toward democracy that we have demonstrated on the embargo?

Mr. SWEENEY. I think that our position has consistently been that we should engage countries that move from communism toward democracy when the countries themselves show that they are indeed moving in that direction.

I contend to you, sir, that in the case of Cuba, it is all smoke and mirrors. Mr. Castro is doing no such thing.

Mr. RANGEL. You believe the embargo is effective?

Mr. SWEENEY. I do believe that the embargo is effective now, since 1992. But I think that its effectiveness, more than anything else, is in reminding the rest of the civilized world that the principles on which the embargo was originally based, which were that Castro should open up the Cuban economy, that Castro should stop repressing dissidents opposed to communism——

Mr. RANGEL. No, no, I understand.

Mr. SWEENEY. Those principles are noble, and they still stand.

Mr. RANGEL. I understand the principles. But I need some answers here.

Do you really believe that Helms-Burton is going to become law?

Mr. SWEENEY. Do I believe that it will become law?

Mr. RANGEL. Yes.

Mr. SWEENEY. Well, that is up to Congress to decide, sir.

Mr. RANGEL. OK. Do you believe if it was law that it would be effective?

Mr. SWEENEY. Yes, sir, I do.

Mr. RANGEL. You really believe that our allies and those that have signed the treaties with us would yield to the pressures that we would have in not doing business with them if they——

Mr. SWEENEY. I think many of our allies who are already doing business with Cuba, particularly private corporations from these foreign countries that are doing business with Cuba, have a longer term concern, which is who are they going to answer to the day Cuba is free and the rightful owners of the property they are dealing with ask for their property back.

Mr. RANGEL. Please, Mr. Sweeney, that red light is going to hit me right in the eye.

Let me ask you: I am just saying, do you believe that the countries that we have trade agreements with would yield to the pressures under the Helms-Burton bill?

Mr. SWEENEY. I cannot answer that, sir. We will have to wait and see.

Mr. RANGEL. OK. Do you have any idea as to who we would be dealing with with a post-Castro Cuba?

Mr. SWEENEY. I think there are many people in Cuba who will emerge from all points on the spectrum to try and rebuild their society. I could not identify anybody by any specific name. But there are many, many thousands of people out there and——

Mr. RANGEL. Mr. Sweeney, Mr. Sweeney, listen. OK. If I wanted to help this movement, you could not help me to identify someone that we could support, that we could deal with in post-Castro——

Mr. SWEENEY. Oh, I am sure I could do so, but not right here and now. I would have to go back and get the information. But it is there.

Mr. RANGEL. OK. And there is no question in your mind that it would not be Castro's brother that we would have to deal with, is there?

Mr. SWEENEY. I do not think so.

Mr. RANGEL. OK. Thank you, Mr. Chairman.

Chairman CRANE. Thank you.

Mr. Shaw.

Mr. SHAW. Just a brief question, so perhaps we can release this panel before we go for a vote.

But, Mr. Rogers, you heard Mr. Smith mention that he thought the economy was undergoing a certain amount of improvement.

Do you agree with that?

Mr. ROGERS. Oh, I think they have entered into what they have labeled reforms, and there has been a certain amount of, if you will, relief from the restraints that were imposed on the economy in terms of farmers' markets, self-employment, and so forth. But these are miles and miles and miles away from the kind of fundamental restructuring that the Cuban economy must go through if it is to become an effective world-class competitor in the——

Mr. SHAW. Yes. But do you see—do you see a degree of improvement, or do you see it as——

Mr. ROGERS. In the economy?

Mr. SHAW [continuing]. A stagnation or a freefall?

Mr. ROGERS. I do not see any significant improvement. Frankly, I think it went down like a stone for several years after the withdrawal of the Soviet subsidy. It may be bouncing along at the bottom now. But I do not see any major recapturing of the 40 percent loss of production that has occurred in the last 4 years.

Mr. SHAW. OK, thank you.

Thank you, Mr. Chairman.

Chairman CRANE. Well, I want to apologize to all of you folks for these interruptions, and I want to express appreciation to all of you for your testimony today.

And as I have indicated earlier, anything in your written statements or beyond your written statements will be made a matter of or a part of the permanent record.

And with that, we will temporarily recess the committee to handle this vote, and the next panel will be summoned probably in about 10 minutes.

The committee stands in recess.

[Recess.]

Mr. SHAW [presiding]. Perhaps the next panel could go ahead and be seated. We have Mr. Sanchez, who is a member of the board of directors of the Cuban-Amercan National Foundation. The next name I am going to have trouble with.

Pronounce your name, please, sir.

Mr. GUTIERREZ. Nicholas Gutierrez.

Mr. SHAW. Yes. Who is secretary of the National Association of Sugar Mill Owners of Cuba; and Sandra Alfonso, who is chairman of the Governor's Pan American Commission, State of Louisiana.

As the Chairman has told the prior panels, your full statement will be put in the record. Please feel free to summarize.

And with that, Mr. Sanchez, if you would proceed, please.

STATEMENT OF IGNACIO SANCHEZ, MEMBER, BOARD OF DIRECTORS, CUBAN AMERICAN NATIONAL FOUNDATION

Mr. SANCHEZ. Thank you, Mr. Chairman, and Mr. Rangel. Thank you for the opportunity to be here today to testify on the issue of Cuba's future.

Most of us here know the tragic situation prevailing in Cuba today—a bankrupt economy, a fractured society, and a stagnant dictatorship incapable of responding to a national crisis.

Yet within this tragedy, there is hope, hope of what Cuba can be in the future if we have a freely elected government in place and one that supports free-market policies and human dignity.

However, in order to discuss a hope-filled future for Cuba, we must begin by categorizing it as a post-Castro Cuba.

It is important to emphasize that when we consider the various strategies for Cuba's political, economic, and social renewal, there can really be only one starting point, the removal of Fidel and Raul Castro from power and the elimination of every vestige of their discredited rule. Any hope for Cuba's successful return to the family of nations depends on a clean break from the last 35 years. Simply put, the Castro brothers are part of the problem in Cuba and cannot be part of the solution.

To the contrary, a fundamental benchmark for a successful transition includes the implementation of rapid comprehensive reform in all respects—legal, regulatory, economic, and political.

It is only by setting up a truly free-market system that Cuban democracy can be guaranteed. Half measures can be worse than no reform at all, because failure to rapidly improve living standards and include all segments of the population in the reform process undermines political support for positive change.

A transitional government will need to move quickly on a variety of fronts, including immediate requests, most likely for international assistance required to meet basic needs. They should address the liberation of political prisoners, elimination of State control over the media, elimination of the compulsory military draft, just as some examples.

The provisional government must also be laying the groundwork for a State based on the rule of law and due process that ensures the physical integrity of all its citizens and has absolute respect for human, civil, and political rights. Most of these items are recognized and called for by the Cuban Liberty and Solidarity Act presently before this Congress.

Beyond these essential steps, however, the fundamental prerequisite for significant and lasting change in Cuba, Mr. Chairman, is democratic elections. Within a 1-year period after the formation of a transitional government, Cuba should convene free and fair multiparty elections, supervised by the international community, that permit equal access to the mass media for all political entities.

It is surprising to hear any kind of suggestion that we should have "our man in Havana" designated before we discuss any transition in Cuba. That impediment, the Castro brothers, is exactly

what is preventing that kind of national leader from arising within Cuba. If we remove the impediment, the Cuban people will elect its leaders, and then we can deal with whoever they freely elect to be their leaders.

Whatever the new democratic leadership or whoever it is must move rapidly to eliminate all political organs of the present regime and replace the communist constitution with a document that recognizes individual rights and includes checks and balances that ensure the separation of powers, including a strong and independent judiciary.

In our opinion, the guiding principles of Cuba's economic reconstruction should be the following: Economic self-reliance; a rapid implementation of a broad-scale privatization program, ensuring that every citizen on the island has a stake in the economic revival; and vigorous free trade.

And by discussing that every citizen have a stake, we are talking about valid foreign investments in Cuba. We are not talking about the present foreign investments where people invest in stolen properties, who invest and provide wages at slave labor wages, as opposed to the rosy picture that we heard being described here before.

The top priority of Cuba's reconstruction efforts should be a privatization plan that puts the means of production in private hands as quickly as possible.

Closely related are the issues of property claims and current commercial agreements. First we must recognize that former property owners in Cuba were the victims of massive illegal acts by the Castro regime and its wide-scale expropriation of property without compensation. Any privatization program must take this into account.

And second and very importantly, the repudiation of foreign commercial agreements with the Castro regime by a post-Castro leadership is essential and would not have a negative effect on investor confidence. To the contrary, it would create investor confidence that the new regime is acting on the basis of the rule of law.

All those currently doing business in Cuba are well aware of the risks they took in dealing with a regime that traffics in stolen property, and they should not expect to profit from it.

Finally, a final factor in the economic success would be the creation of a free-trade policy that is applied equally and consistently across the board with no discrimination toward industry, economic groups, or individuals. And all producers of goods or services, whether Cuban-made or foreign-made, should compete fairly and equally in Cuba, and toward this end, Cuba should welcome free trade agreements with other nations.

Mr. Chairman, obviously my time is up, and I would request that I be given an opportunity until next week to submit a written statement, since we did not know we were coming up until yesterday.

But if I could have 30 seconds just to conclude my remarks?

Chairman CRANE [presiding]. Go ahead and proceed.

Mr. SANCHEZ. In conclusion, Mr. Chairman, the future of a post-Castro Cuba can be bright. But first we must rid the island of the

tyranny that clings to power there. That is why the U.S. present policy or a firm policy on the embargo are critical.

In short, the pressure is working. The bill presently before Congress will hasten Castro's fall. And that is the reason why we have such a massive effort by the Castro regime seeking to lift the embargo and opposing the bill.

Thank you.

[The prepared statement follows:]

TESTIMONY OF IGNACIO SANCHEZ
CUBAN AMERICAN NATIONAL FOUNDATION

Thank you Mr. Chairman and Mr. Rangel. I appreciate the opportunity to be here today to testify on the issue of Cuba's future.

Most of us here know the tragic situation prevailing in Cuba today - a bankrupt economy, a fractured society, and a stagnant dictatorship incapable of responding to a national crisis. Yet within this tragedy there is hope. Hope of what Can be, once a freely elected government is in place, one that pursues free market policies and respect for human dignity.

I believe, however, that in order to discuss a "post-embargo Cuba" there is an important moral imperative to look at it in terms of a "post-Castro Cuba". To begin with, I think it is important to emphasize that when we consider the various strategies for Cuba's political, economic, and social renewal, there can be only one starting point - the removal of Fidel and Raul Castro from power and the elimination of every vestige of their discredited rule. Any hope for Cuba's successful return to the family of nations depends on a clean break from the past thirty-five years. Simply put, the Castro brothers are the problem in Cuba and cannot be part of the solution. Fidel Castro had every opportunity in the past three decades to build a viable socio-economic system but sacrificed all to aggrandize his power.

Based on that premise I would like to share with you today our vision, and the recommendations that we at the Cuban American National Foundation have prepared to offer a pst-Castro transitional government to help it on the path to a new age of freedom and economic prosperity that the Cuban people - on the island and in exile - yearn for.

Indeed, when we examine the experiences of countries in the former East bloc that have succeeded in the transition from totalitarian political systems and centralized economies to democracy and free-market economies - countries such as Poland, Hungary, and the Czech Republic - the successful ones are those that prevented the bureaucracies which existed at the downfall of their communist regimes from directing or controlling the reconstruction effort.

These inept bureaucracies, totally lacking in free-market expertise and seeking only to retain their existing privileges, are incapable of carrying out a transition to freedom. Therefore, it is essential that the transition in cuba be carried out by individuals who understand the people's needs and are committed to providing justice and equality of opportunity for all.

Another fundamental benchmark for a successful transition to a democratic government and a free-market economy is the implementation of rapid, comprehensive reform in all respects: legal, regulatory, economic, and political. It is only be setting up a truly free-market system that Cuban democracy can be guaranteed. Half measures can be worse than no reform at all because failure to rapidly improve living standards and include all segments of the population in the reform process undermines political support for positive change.

It is important to understand, that any new leadership assuming power in Cuba will inherit a nation with virtually no financial resources, an infrastructure devastated by more than three decades of neglect, and a bitter legacy of state control over all aspects of the nation's social and political life.

A transitional government will need to move quickly on a variety of fronts, most likely to include an immediate request for international emergency assistance, such as food and medicine, required by the people of Cuba to meet their basic needs during the transition period; the immediate liberation of all political prisoners; the elimination of all state control over the media; and the abolition of the compulsory military draft. The provisional government must also begin laying the groundwork for a state based on the rule of law and due process that ensures the physical integrity of all its citizens and absolute respect for human, civil, and political rights.

Beyond those essential steps, however, the fundamental prerequisite for significant and lasting change in Cuba is democratic elections. Within one year of the formation of the first transitional post-Castro government, Cuba should convene free and fair, multiparty elections supervised by the international community that permit equal access to the mass media for all political entities. Only a freely elected government chosen in internationally supervised elections will have the necessary international and legal standing to undertake the reforms that will bring back the peace and prosperity the Cuban people deserve.

A new democratic leadership must move rapidly to eliminate all political organs of the present regime and place the 1976 socialist constitution with a document that recognizes individual rights and includes checks and balances that assure separation of powers of the state, as well as the creation of an independent judiciary. The new Cuban constitution should also strengthen political authority at the provincial and local level, thereby shifting the power away from the central government in havana.

Of paramount importance is reversing Cuba's prolonged decline under Castro and building a solid foundation for sustained recovery. The new constitution must protect private commercial activity by recognizing the rights to private property and to freely enter into contracts. It must also ensure full participation by every Cuban citizen in market-oriented development.

Despite the depth of economic despair on the island today, there is reason for optimism regarding Cuba's future. Given the strength of the Cuban economy before Castro's rise to power, regional economic powers such as Venezuela and Argentina can be held as appropriate benchmark's for Cuba's economic potential. Proximity to the world's largest market and traditional trade ties to the United States will provide a powerful catalysts for economic revival in a new democratic Cuba.

In our opinion, the guiding principles of Cuba's economic reconstruction should be the following: (1) economic self-reliance; (2) a rapid implementation of a broad-scale privatization program ensuring that every citizen on the island has a stake in the economic revival of the country; and (3) vigorous free trade.

A new, democratic Cuban leadership should not count on the assistance from international lending agencies or governments to rebuild Cuba. Too many countries around the world have relied on somebody else to solve their economic problems. We have learned the lesson- if you get in the international welfare line and wait for a handout, nothing will happen. Indeed, the best way to guarantee the independence and sovereignty of Cuba is not through international assistance programs, but rather by letting the private sector grow.

Therefore, the top priority of Cuba's economic reconstruction effort should be a privatization plan that puts the means of production in private hands as quickly as possible while respecting the rights of all. To work and be respected, any privatization program must provide an opportunity in which the entire Cuban population can participate and be the product of the will of the Cuban people as expressed in a free and democratic election.

Funds from an aggressive privatization program will be needed to: first, provide normal government services, such as education and public health; second, to pay for administration of government reconstruction programs, including privatization; and third, to establish and maintain an unemployment fund to offset the dislocation of workers until they can be reabsorbed by the market.

Fortunately, the new Cuban leadership will have the extensive experience of Latin America, Europe, and the former Soviet bloc countries to serve as a guide for effective action. The Czech republic, for example has implemented innovative programs to sell 22,000 small businesses and more than 2,000 large enterprises worth some $17 billion to private hands. The first round of privatization bids was restricted to Czech citizens, with enterprises set at book value. A national voucher plan instituted by the Czech government that provided voucher coupons to each citizen to obtain a stake in newly privatized industries was enormously successful.

Closely related are the issues of property claims and current commercial agreements with the Castro government. We must recognize that former property owners in Cuba were the victims of a massive illegal act by the Castro regime in its wide-scale expropriation of property without compensation. Any privatization program must take this into account. At the same time, the privatization program should not be undermined by a lengthy process of property adjudication.

The one exception to properties subject to restitution should be homes of Cuban citizens on the island. The eviction of Cuban citizens from their homes is simply not in the interest of the country. Therefore, former home owners should be compensated rather than have those properties returned to them.

The repudiation of foreign commercial agreements with the Castro regime by a post-Castro leadership is essential and would not have a negative effect on investor confidence in a new Cuba. On the contrary, it will reinforce confidence that the new Cuban government will act on the basis of law and not on the whims of one man.

All those currently doing business in Cuba are well aware of the risks they took in dealing with stolen property and the Castro regime, and they should not expect to profit from those dealings. It will, of course, be up to the Cuban people to decide how to handle this matter.

The final factor in the economic success of a new Cuba will be the creation of a free-trade policy that is applied equally and consistently across the board without discrimination toward specific industries, income groups, or individuals. All producers of goods and services, be they Cuban or foreign, should compete fairly and equally in a new Cuba.

This would require establishing new constitutional and regulatory provisions to allow producers to engage in economic activities without restrictions on foreign or domestic investment. Cuba should welcome free-trade agreements with other nations - to engage in NAFTA - but the Cuban people should not be held hostage to the negotiations for those agreements by withholding the immediate benefits of free trade.

A key factor that the countries of Eastern Europe lacked in their transitions was the presence of a prosperous exile community knowledgeable in the ways of the free market. Cuban exiles are prepared to make a substantial contribution to the economic revival of a post-Castro Cuba. A new Cuba could expect capital inflows from Cuban-Americans alone of more than 2$ billion in the first year of transition alone. More than 64,000 small and medium-sized businesses owned by Cuban-American will provide a ready source of entrepreneurial experience and potential investment.

The social reconstruction of Cuba, unfortunately, will be a grater challenge. Thousands of Cubans have lost family members and possessions and have suffered greatly over the past thirty-five years. The state, with its notorious neighborhood watch committees, has permeated every facet of society, from civic groups to sports clubs, and even intervening in family matters.

Yet Cubans must not allow hatred, revenge, and mistrust to be the social legacy of the Castro regime. Forgiveness, patriotism, and solidarity of purpose should be the appropriate instruments for attaining social peace and promoting the material, moral, and spiritual; reconstruction of the nation. Respect for the individual freedom and the universal right to equality of opportunity should be the pillars upon which is built a peaceful and long-lasting social accord that embraces all Cubans.

Key to this will be the promotion of civic awareness to prevent the establishment of new dictatorships based on old military power structures or excessive government control. As the family is the fundamental nucleus of society, so local and municipal government should be the nucleus of Cuba's political life. Thus, the active participation of the citizenry should strengthen the municipal structures while decentralizing the government and reducing its power.

The country's democratic institutions should guarantee respect for minorities, without exclusions or discrimination; protection of the environment; free exercise of religion or a set of beliefs; free elementary and high school education; adequate medical

attention and public health; freedom of expression, along with equal access to the media; the right to personal honor and self-respect; freedom of assembly, association, migration, and movement, including full freedom to travel nationally and internationally.

A new democratic Cuba leadership should strengthen society by allowing the participation of Cubans in civic activities and respecting their right to influence, in an organized manner, the nation's public agenda through criticism, petitions, initiatives, and suggestions. All Cubans should have the right to organize freely without the coercive pressures of other citizens or governmental entities, thus fostering the creation of national, provincial, and municipal chambers of commerce, labor unions, and associations (e.g. professional, industrial, agricultural, civic, fraternal, charity, religious, artistic, and intellectual).

In conclusion, Cuba today stands at a crossroads. As long as Castro demands market-oriented growth without free markets, Cuba's economy will continue to worsen. Answering Castro's call for travel and trade with the United Sates without allowing the liberties and human rights he denies the Cuban people will only provide fuel for the machinery of repression on the island.

That is why U.S. policy and the embargo are critical. In short, the pressure is working. Castro's decision to legalize the dollar and risk the political costs is certainly a attests to the abysmal state of the Cuban economy and why the unilateral lifting of the embargo has become the "Number One" foreign policy priority of the Castro dictatorship. Castro knows that trade and diplomatic benefits from relations with the U.S. would provide critically needed resources and a symbolic victory for the beleaguered regime. It is his last hope to maintain his grip on power.

For these reasons, we have a moral imperative to support the embargo despite the siren songs and Castro's shrill campaign to lure U.S. businesses and foreign investments. WE cannot forget that what sparked the recent refugee crisis last August were 30,000 Cubans parading through the streets of havana demanding and end to Castro's rule. WE have a responsibility to eleven million Cubans. As Cuban dissidents have oftentimes states: if an embargo was good for Haiti and South Africa, it is also necessary to promote freedom and democracy for the Cuban people.

I believe the Cuban people will soon regain control of their destiny by taking back those rights denied then for decades. History will not absolve Fidel Castro, as he once claimed, but it will condemn him for his crimes against the Cuban people and his failed policies that have left his once-prosperous island bankrupt.

Rebuilding will perhaps be the greatest challenge ever faced by Cuba. Many of the choices and recommendations will be offered to the Cuban people after Castro. Experience proves the best alternative is one that includes a truly free market in the context of a free society. Yet, ultimately, of course, it will be the choice of the Cuban people to make.

Thank you very much.

Chairman CRANE. Thank you.
Mr. Gutierrez.

STATEMENT OF NICOLAS J. GUTIERREZ, JR., SECRETARY AND MEMBER, BOARD OF DIRECTORS, NATIONAL ASSOCIATION OF SUGAR MILL OWNERS OF CUBA, INC.; AND ALSO ON BEHALF OF THE NATIONAL ASSOCIATION OF SUGAR CANE GROWERS OF CUBA AND THE NATIONAL FEDERATION OF SUGAR WORKERS OF CUBA

Mr. GUTIERREZ. Yes, thank you, Mr. Chairman, members of the subcommittee.

I am representing the National Association of Sugar Mill Owners of Cuba. I am the secretary and a member of its board of directors. I am accompanied by our president, Alberto Beguiristain, who is here with me today. And I am also representing the National Association of Sugar Cane Growers of Cuba and the National Federation of Sugar Workers of Cuba. So we have management and labor both represented here, and both with the same position.

Cuba's sugar industry accounts still for about 75 percent of the country's hard currency revenues and employed well over half a million people before it was nationalized by Fidel Castro.

Today, Cuba is even more heavily dependent on sugar than before. Under the progressive Sugar Coordination Law of 1937, Cuban sugar production was efficiently coordinated among the mill owners—"hacendados" in Spanish—the cane growers of which there were over 65,000—"colonos" in Spanish—and the "trabajadores" or workers that were employed in the agricultural as well as the industrial, sides of this vast agro-industry in Cuba. These workers numbered over half a million.

Today these same Cuban sugar workers—and this should be of special interest to Congressman Rangel, who has always had a great interest in labor matters—get the equivalent of 4 cents a day for 10 hours of work, 10 hours of work, which they do without any shirts and without any shoes, just to give you an idea of the "workers" paradise in Castro's Cuba and the conditions that Cuban workers work under.

Having been subjected to the grossly inefficient Socialist model of centralized planning, Cuban sugar production is currently at its lowest level in several decades.

In his desperation to somehow replace his massive Soviet subsidies of the cold war era, Fidel Castro is actively courting foreign enterprises to invest in, among others, Cuba's vital sugar industry.

Faced with foreign skittishness about acquiring property without clear title, the Cuban dictator has even resorted to attempting to lure the mill owners to take a percentage interest in joint ventures with Cuban State-owned companies and with foreign investors in our own confiscated mills. We, of course, have rejected all such proposals.

We are, however, currently lining up the requisite financing, so that after we obtain the restitution of our mills, we will be able to put them into production, employing Cuban workers at a real wage—not in the worthless pesos that they are paid in today—and creating a "multiplier effect" across the island that will rapidly

bring prosperity back to Cuba and get the Cuban economy back on its feet as quickly as possible.

This is what Cuba needs.

Congressman Rangel has asked who the leaders in Cuba are today, and who we may have in mind.

As Mr. Sanchez noted, of course, we have no one in mind. The Cuban people will have to determine this.

But if the Congressman wants the names of some dissidents and opposition organizations in Cuba that are currently and courageously working against the Castro regime—obviously they do not have the freedom to travel here and testify themselves, but they have authorized me to say their names. And I might add, at great personal risk to themselves.

We have put these three individuals that I am going to mention on Puente's Spanish, the abbreviation for "Bridge of Young Professionals" radio programs. Although you will notice that they are not the favored dissidents that get most of the media attention in the United States, but these individuals are working effectively inside of Cuba. Through Puente's radio program, we have called them on the phone with the new telecommunication direct links to Cuba and broadcast them live on the air——

Yes, sir?

Mr. RANGEL. I do not mean to interrupt you. If mentioning these names publicly would in any way jeopardize the safety of these individuals, then I would much prefer that you not do that publicly.

My question was directed at people who might have already expressed what they were doing. But I certainly hope that you do not mention any names here at my request that would put anyone's life or welfare in jeopardy.

Mr. GUTIERREZ. Let me continue with my remarks. And then maybe I can mention their names. They did ask me to mention their names, so I would like to live up to that commitment.

Mr. RANGEL. But not at my request. They want their names mentioned, you mention them.

Mr. GUTIERREZ. Understood. The most effective vehicle that we believe exists for rapidly unleashing the creative energies of the Cuban people, both in exile and on the island, is the establishment of a free market economy, built upon the restitution of property to its legitimate owners, with fair-market value compensation awarded under a flexible conflict resolution framework in the cases of materially altered properties and residential housing currently occupied by Cubans without any ties to the repressive state apparatus, be they Americans, Cuban-Americans, or Cubans who remained on the island.

What we are talking about essentially is not such a radical idea. The reestablishment of the rule of the law in Cuba, that is what is necessary to bring about both prosperity and social peace on the island. And if I might just conclude by saying, that by building the new economy around this seasoned entrepreneurial class, Cuba can assure itself of proven talents in the areas of producing economic growth and providing rising living standards, while restituting owners with historical ties to the land and an established recognition of the pre-Castro labor rights of Cuban workers. Thank you.

[The prepared statement follows:]

TESTIMONY OF NICOLAS J. GUTIERREZ, JR.
NATIONAL ASSOCIATION OF SUGAR MILL OWNERS OF CUBA

Chairman Crane and members of the Sub-Committee on Trade of the Committee on Ways and Means of the House of Representatives of the United States, good afternoon. My name is Nicolás J. Gutiérrez, Jr. and I am an international corporate attorney with the law firm of Ruden, Barnett, McClosky, Smith, Schuster and Russell, P.A. in Miami, Florida. I sincerely appreciate the opportunity to address you today on behalf of the National Association of Sugar Mill Owners of Cuba (the "Mill Owners"), in which I serve as the Secretary and a member of its Board of Directors; the National Association of Sugar Cane Growers of Cuba (the "Cane Growers"); and the National Federation of Sugar Workers of Cuba (the "Sugar Workers") (collectively, the "Sugar Industry"). The Mill Openers represent the legitimate owners of nearly all of Cuba's 161 sugar mills, which were forcibly and unlawfully confiscated without any compensation whatsoever by the Castro regime back in 1960. Thirty-five of these mills were owned by U.S. corporations at that time. My family owns two of these mills in the Las Villas province of south central Cuba near Cienfuegos (today, the site of the infamous Juraguá nuclear plant), a medium-sized one located near Cruces named "San Agustín" (the communists have re-named it "Ramón Balboa" and it is now in the newly created province of Cienfuegos) and a slightly smaller one named "Pastora" near San Juán de los Yeras (now called "Osvaldo Herrera" and in the new province of Villa Clara), as well as other significant properties involving sugar cane growing, cattle, coffee, rice, wholesale food distribution, distilling, banking, insurance, oil production, rental housing, hardware, detergents and textiles.

Historically, Cuba's sugar industry accounted for approximately 75% of the country's hard currency revenues and employed well over half a million workers, before it was nationalized by Fidel Castro. Today, Cuba is even more heavily dependent on sugar than before. Under the progressive Sugar Coordination Law of 1937, Cuban sugar production was efficiently coordinated among the Mill Owners (in Spanish, "hacendados"), the over 65,000 Cane Growers (in Spanish, "colonos") and the approximately 500,000 agricultural/industrial Sugar Workers (in Spanish "trabajadores"), in an equitable partnership which served as a great economic engine for growth and progress throughout the development of the Cuban nation.

Having been subjected to the grossly inefficient socialist model of centralized planning, Cuban sugar production is currently at its lowest level in several decades. In his desperation to somehow replace his massive Soviet subsidies of the Cold War era, Fidel Castro is actively courting foreign enterprises to invest in, among others, Cuba's vital sugar industry. Faced with foreign skittishness about acquiring property without clear title, the Cuban dictator has even resorted to attempting to lure the Mill Owners to take a percentage interest in joint ventures with Cuban state-owned companies and foreign investors in our own confiscated sugar mills. The Mill Owners have, of course, refused all such outlandish proposals. The Mill Owners are, however, currently working on lining up the requisite financing, so that after we obtain the restitution of our confiscated mills in a post-Castro Cuba, we can put them into production, employ Cuban workers with full labor rights at a decent wage payable in a currency with value (unlike today's Cuban "peso"), create a "multiplier effect" across the island and help get the Cuban economy back on its feet, as quickly as possible.

The Sugar Industry, which includes Cubans on both sides of the Florida Straits, believes that the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1995 is a very effective vehicle for supporting the Cuban people in its struggle to bring an end to the totalitarian dictatorship, while facilitating a post-Castro transition to prosperity bolstered by the respect for private property rights.

The Sugar Industry does not accept the disinformation campaign emanating from Havana, which is echoed by some opponents of LIBERTAD here in the United States and abroad, that the Cuban people are overwhelmingly opposed to this promising legislation. All of our communications with Cubans, either inside the island or those who have recently arrived in the U.S. or elsewhere (some of which were growers, technicians or workers at our sugar mills), demonstrate that the opposite is in fact true. Indeed, on three separate occasions during the last few weeks, the Bridge of Young Cuban Professionals has transmitted its radio programs on local Miami stations WCMQ and WQBA, respectively, during which opposition leaders inside of Cuba have been contacted by telephone (capitalizing on the new direct telecommunications links with the island) and put on the air to publicly and explicitly endorse (in great detail and at the risk of

brutal repression) various provisions of LIBERTAD, particularly its Title III dealing with the protection of private property rights. These courageous individuals, each of which openly gave his actual name and organization, are: (i) Elizardo Sampedro Marín (President of the Partido Solidaridad Democrática in Havana); (ii) Adolfo Fernández Saínz (President of the Central Sindical Cristiano in Havana); and (iii) Aurelio Sánchez Salazar (President of the Partido Social Cristiano in Camagüey). Each of these organizations is part of a nationwide coalition of like-minded opposition groups called the Unión Opositora Cubana, which is active throughout Cuba's fourteen new provinces.

It is an often overlooked fact that the U.S. initially imposed its trade embargo on Cuba well over three decades ago, not because of Fidel Castro's flagrant human rights violations or blatant interventions in the affairs of other nations, but, rather, in response to his massive illegal confiscations of the properties of American citizens and corporations in Cuba, as memorialized by revolutionary Law No. 851 which appeared in the "Gaceta Oficial" (Cuba's official registry/bulletin of new legislation) on August 6, 1960. These completely uncompensated takings, which were valued then in the many hundreds of millions of dollars, were directly violative not only of Articles 24 and 87 of Cuba's 1940 Constitution (which Castro had promised to restore after ousting General Fulgencio Batista), but of international law, as well. Consequently, U.S. law, from the Foreign Assistance Act of 1961 (and its Hickenlooper-González Amendment) to the Cuban Democracy Act of 1992, has been consistently clear that there can be no lifting of the embargo, extension of diplomatic recognition or provision of foreign assistance to Cuba, until there is an adequate resolution of the certified pre-adjudicated claims of these American citizens filed with the Justice Department's specially created Foreign Claims Settlement Commission (the "Commission").

This principled stance, however, should not constitute the sole aim of U.S. foreign policy, with respect to private property rights in a post-Castro Cuba. For as reprehensible and indefensible as were the confiscations of American properties in Cuba, they only represented a small fraction of Cuba's total economic assets. The vast majority of all properties in Cuba were subsequently systematically confiscated by the communist state from Cuban owners (which now number in the several millions), by force and without any compensation. This blatantly unconstitutional process was initiated with Law No. 890 on October 15, 1960 (which seized the major Cuban-owned industries) and then completed through the infamous "Agrarian and Urban Reform Acts," as well as through the cynical confiscations of "abandoned property." While many of these owners are now naturalized U.S. citizens, most of them (primarily of the mid to smaller-sized properties) are still in Cuba.

Ever mindful of the sovereignty of a post-Castro democratic Cuban government, the U.S. should employ the full weight of its regional influence and special geopolitical relationship to assist Cuba in establishing a sound legal and moral foundation for the restructuring of the Cuban economy. Through a privatization program based upon the restitution of properties to their legitimate owners, Cuba can reverse the monstrous injustice of the Castro-era confiscations, while simultaneously inspiring confidence in foreign investors to participate in building a future for Cuba, secure in the knowledge that their investments will be fully protected by law.

Indeed, the most effective vehicle for rapidly unleashing the creative energies of the Cuban people, both in exile and on the island, is the establishment of a free market economy built upon restitution to the legitimate owners (with fair market value compensation awarded under a flexible conflict resolution framework in the cases of materially altered properties and residential housing currently occupied by Cubans without any ties to the repressive state apparatus) -- be they Americans, Cuban-Americans or Cubans who remained on the island. By building the new economy around this seasoned entrepreneurial class, Cuba can assure itself of proven talents in the areas of producing economic growth and providing rising living standards, while restoring owners with historical ties to the land and an established recognition of the pre-Castro labor rights of Cuban workers.

This approach also features the additional practical advantage of sparing a financially struggling new Cuban government from utilizing its scarce resources, and further indebting itself, in attempts to compensate legitimate owners through cash, bonds or vouchers. After Castro's

disastrous socialist economic policy experiments, unjustified expenditures on armaments and foreign military adventures have thoroughly bankrupted the Cuban state, this advantage is a very significant one to the Cuban people.

If we are to learn anything from the recent experiences of formerly communist Central/Eastern Europe and Nicaragua, it is that the privatization process in these countries has been hampered by a loss of legitimacy, social unrest, economic stagnation and disincentives for foreign investment to the extent that some of the post-Iron Curtain governments have deviated from the restitution model. This failure to protect property rights causes the type of impoverishment, which inevitably leads to an over-dependence on foreign (principally U.S.) assistance.

Obviously, however, the restoration of respect for private property rights in Cuba must be preceded by the sweeping of the Castro brothers and their inner circle from power on the island. LIBERTAD, introduced by Senator Jesse Helms (Chairman of the Senate Foreign Relations Committee) and Rep. Dan Burton (Chairman of the House Western Hemisphere Affairs Sub-Committee) with extensive bipartisan support in both chambers of the U.S. Congress, includes various international embargo-tightening provisions and post-Castro assistance incentives designed to support the Cuban people in accelerating this desperately needed dramatic change.

The Sugar Industry has a particular interest in Section 109 of LIBERTAD, which would prevent Canadian, Mexican and other foreign companies from circumventing the U.S. embargo by importing cheap Cuban sugar (produced by workers without any labor protections in confiscated sugar mills and farms), processing it domestically and then shipping it into the United States market. This provision would reduce, re-allocate or even eliminate such countries' sugar import quotas into the U.S.

Likewise, the Industry considers Section 202 of LIBERTAD to be vital to Cuba's post-Castro economic recovery, with its provisions for financing, guarantees, assistance and favorable trade arrangements to be offered by the U.S. to a future democratically elected government in Cuba. This will be of great importance to the Sugar Industry, which will no doubt be counted upon to lead Cuba out of its current economic deprivation, socialist mismanagement and loss of its historic three million-ton U.S. sugar quota before Castro's revolution.

On the property rights front, LIBERTAD seeks to hasten this inevitable reality by building upon the commendable bipartisan efforts of the Department of State, with respect to its two previous "buyer beware" cables to American diplomatic posts worldwide. The first of these was sent in 1991 by the Bush State Department, and the second two years ago under the Clinton Administration. These communications explicitly warned foreign nationals of the legal and diplomatic consequences of purchasing or leasing confiscated U.S. properties in Cuba. These warnings were broadened last year (in diplomatic cables to the United Kingdom, the Netherlands and Honduras, among others) to also put foreign countries and companies on notice that nearly all of the non-U.S. properties that Castro is currently peddling to international investors, in a desperate attempt to obtain enough hard currency to keep his faltering dictatorship afloat, were stolen from their legitimate Cuban owners. Furthermore, the Treasury Department's Office of Foreign Assets Control's long overdue initiative of extending the existing embargo to foreign companies engaged in joint ventures with the Castro regime by labeling them as "specially designated nationals" is another very positive development, in this respect. LIBERTAD would codify the internationally well-established legal proscription and sanctions against trafficking in stolen goods with knowledge of their illicit origin, thereby deterring foreign investment in Castro's Cuba by criminalizing this activity.

Additionally, the U.S. can seize the moral high ground by making clear that it will weigh in during the post-Castro property debate in Cuba in favor of the proposition that foreigners, who helped extend Castro's brutal reign with their investments, should have their properties auctioned off without any compensation. This would constitute an unmistakably powerful signal that will keep many foreign nationals from straying from the right side of history by investing in Cuba today.

Specifically, Section 302 of LIBERTAD establishes a new federal statutory cause-of-action whereby legitimate owners, whether they became U.S. citizens before or after Castro's confiscation of their properties back in Cuba, can seek to block these ongoing sales or leases of confiscated goods by seeking damages (after due notice, even treble damages) and attaching the U.S. assets of these purchasers in bad faith of such stolen property. Those who seek to limit the availability of this cause of action merely to the 5,911 original certified U.S. claimants under the Commission should consider the following. First, as U.S. citizens today, Cuban-Americans cannot be denied equal access to federal courts, based upon the equal protection clause of the Fourteenth Amendment to the Constitution. Second, although Cuban-Americans were not U.S. citizens when their properties were stolen by the Castro regime, we are U.S. citizens now when Castro is offering our properties to foreign investors, who will be unjustly enriched by their exploitation. Third, the inclusion of Cuban-Americans in Section 302's cause-of-action effectively places the majority of Cuba's economic assets off-limits to foreign investors, who wish to avoid having lawsuits hamper their U.S. operations. Conversely, limiting the cause-of-action only to the original certified U.S. claimants allows foreigners to freely invest throughout the rest of Cuba, thereby failing to achieve the intended broad chilling effect on foreign capital infusions to the Castro regime. Since markets react adversely to the uncertainty generated by litigation, these lawsuits would have the salutary effect of complicating everything from the obtaining of financing to the obtaining of insurance coverage for these purchasers (with prior knowledge) of confiscated properties.

Furthermore, Section 301 of LIBERTAD would deny entry visas into the United States to all executives of foreign companies (plus their employees, relatives and affiliates) which are benefitting from stolen property in Cuba, thereby creating an additional disincentive for foreign investment to prop up the faltering Castro regime. Those that indignantly moralize about the supposed extraterritoriality of LIBERTAD, simply misplace their focus. LIBERTAD does not purport to dictate to any foreign government or company what it should or should not do in Cuba. Rather, LIBERTAD seeks to hold these foreign entities accountable for the consequences of their opportunistic investments in Cuba, when they then seek to continue doing business within the national territory of the United States, where jurisdiction over these matters by the U.S. Congress and federal courts is incontrovertible. LIBERTAD will clarify the choices confronting foreigners, when they are deciding where to invest and transact business.

As for Section 303 of LIBERTAD's authorization of the re-opening of the certified claims process with the Commission to Cuban-Americans who have more recently become U.S. citizens, let me clearly state the Sugar Industry's position. We have no intention of diluting or prejudicing the certified claims of the original U.S. claimants. Moreover, the Sugar Industry does not seek to have the State Department (which has other interests different than our own) either espouse our claims or provide us with a pro rata amount of the eventual (and largely theoretical) claims settlement between the U.S. and Cuba. The Sugar Industry believes that our most effective form of remedy will be to seek the restitution of our confiscated properties in a post-Castro Cuba. A recognition and enumeration of Cuban-American claims by the Commission, however, would increase the Sugar Industry's international leverage by serving as a more formal listing to give notice of ownership to potentially interested foreign investors. This "second tier" of claims would not affect the original claimants, since there would be no corresponding espousal or distribution rights.

The U.S. should employ its unique prestige and influence intelligently in leading the rest of the world in a concerted effort to help the Cuban people liberate themselves from one of the last totalitarian remnants of the Cold War. Similarly, and without timidity about appearing heavy-handed internationally, America should utilize its considerable trade and aid leverage to justifiedly advocate for a sound foundation for Cuba's future by standing tall for democracy, free-markets and constitutional liberties for all Cubans, based upon the restoration of the rule of law. Section 207 of LIBERTAD, which conditions U.S. assistance to a democratic Cuban government upon, among other things, the restitution of or full compensation for properties illegally seized from any U.S. citizens in Cuba, is an effective next step in this direction.

Chairman CRANE. Thank you, Mr. Gutierrez. Ms. Alfonso.

STATEMENT OF SANDRA M. ALFONSO, CHAIRMAN, GOVERNOR'S PAN AMERICAN COMMISSION, STATE OF LOUISIANA

Ms. ALFONSO. Mr. Chairman, distinguished members of this subcommittee, I am honored to be in your presence and to have been granted the opportunity of addressing you on a matter which I perceive to be of great national importance, both economically and politically.

I am Cuban-American, and the chairman of the Governor's Pan American Commission in the State of Louisiana. I will speak today as a citizen of our country, a professional in the field of international trade relations, and as a native Cuban, all in that order.

I arrived in the United States when I was 15 years old. During these last 34 years, I have observed and researched the numerous developments which have surrounded our relations with the island. Many efforts have been implemented to recapture democracy for the Cuban people, as the Cuban Democracy Act clearly identifies.

An embargo has been in place since 1963, and now even stricter economic sanctions are being considered by this Congress, hoping to accelerate its democratization and free market participation. It is unquestionable, the renewal of trade relations with Cuba will bring a fresh and lucrative market to our national business community.

In relation to my State, normal commercial exchange with the island will recuperate the 6,000 jobs lost the day the embargo was imposed, and will recover our number one trading partner. Not taking into consideration that Cuba's population has tripled since our embargo went into effect, and that it is economic restructuring presents unlimited possibilities, our business community would derive very lucrative benefits from unrestricted commerce with Cuba.

Notwithstanding, every day, month and year we do not trade with the island, untold billions of dollars are lost to the U.S. economy. We are all aware that under the present global conditions, where fierce market competition is prevalent, opening fresh and new territories becomes essential to survival in business.

If presently Cuba has a gross national product of $13.7 billion, it would be unfathomable to calculate what the prospect would be under a healthy economy. Close to 12 million people will become instant consumers of our products. Their ability to produce would increase many times over today's GNP, therefore the supply would benefit our acquisition needs.

The island possesses the best educated work force in Latin America, and a free medical system, two extraordinary elements for the success of any investment or business venture. In addition, Cuba's cultural roots have been historically linked with ours, especially with my State.

To this day, its people continue to maintain great affinity with us and our culture, MTV, CNN, jeans, Cokes, et cetera, are not alien to them, in spite of the estrangement. It is quite significant for anyone visiting the island, as I have done several times recently, to realize that there are no remnants of the Soviet Union there, though, perhaps only a very unusual structure used by their

Embassy. However, signs, art, music, et cetera constantly reminds the traveler of the United States.

Gentlemen, nothing I have described could ever be developed if the existing sanctions remain, let alone impose further sanctions. Our business community won't have the opportunity as long as they are excluded from the benefits presented by Cuba's entrance to the world's free market. Under today's existing conditions, and with the possibility of additional constraints, I must wonder.

I must wonder where the balance weights most for us. Do we prefer the Cuban Government's economic hardship over the benefit of our own taxpayers and businesses? Who are we actually punishing when we cannot, in fact, and legally prevent the world from trading with the island.

Perhaps we may be losing more than they do. Yes, we may not have been effective in democratizing them through an embargo, but we are certainly very successful in reducing revenues for our business community.

Is Cuba any worse than Viet Nam, China, North Korea, et cetera, according to our own standards? No. In fact, Cuba today has more essential ingredients for unrestricted commercial exchange than China or Viet Nam had when we resumed trade with those two nations. Moreover, the blood of our children has never spilled on Cuban soil in a war, as it did on the territory of some of our best commercial allies.

In conclusion, I want to remind this subcommittee I envision my native land as the free trading partner we once had. I have the same hopes and aspirations as the majority of the Cuban-Americans, but in contrast, I also sustain our domestic interest as an American.

Gentlemen, as I close, I will quote our Nobel Prize winner, Milton Freeman, "Free markets make free men."

[The prepared statement follows:]

HOUSE WAYS AND MEANS SUBCOMMITTEE ON TRADE

HEARING

ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES CUBA AFTER CASTRO

June 30, 1995

TESTIMONY BY SANDRA M. ALFONSO

Mr. Chairman, distinguished members of this Subcommittee . . . I am honored to be in your presence, and to have been granted the opportunity of addressing you on a matter which I perceive to be of great National importance, economically and politically.

I am Cuban-American, and the Chairman of the Governor's Pan American Commission in the State of Louisiana. I will speak today as a citizen of our Country, a professional in the field of International Trade Relations, and as a native Cuban, all in that order.

I arrived in the United States when I was only fifteen years old. During these last thirty-four years I have observed, and researched, the numerous developments which have surrounded our relations with the Island. Many efforts have been implemented to recapture Democracy for the Cuban people, as the Cuban Democracy Act clearly identifies. An embargo has been in place since 1963. And now, even stricter economic sanctions are being considered by this Congress, hoping to accelerate its democratization and free market participation.

It is unquestionable, the renewal of trade relations with Cuba will bring a fresh and lucrative market to our national business community. In relation to my State, normal commercial exchange with the Island will recuperate the six thousand jobs lost the day the Embargo was imposed, and will recover our number one trading partner. Not taking into consideration Cuba's population has tripled since our embargo went into effect, and that its economic restructuring presents unlimited possibilities, our business community would derive very lucrative benefits from unrestricted commerce with Cuba.

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In addition, Cuba's cultural roots have been historically linked with ours, specially with my State. To this day, its people continue to maintain great affinity with us and our culture. MTV, CNN, jeans, Cokes, etc. are not alien to them, in spite of the estrangement. It is quite significant for anyone visiting the Island, as I have done several times recently, to realize there are no remnants of the Soviet Union there, though perhaps only a very unusual structure used by their embassy. However, signs, art, music, etc., constantly reminds the traveler of the United States.

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China, North Korea, etc., according to our own standards? No. In fact, Cuba today has more essential ingredients for unrestricted commercial exchange than China or Vietnam had when we resumed trade with those two nations. Moreover, the blood of our children has never been spilled on Cuban soil, in a war, as it did on the territory of some of our best commercial allies.

In conclusion, I want to remind this Subcommittee, I envision my Native Land as the free trading partner, we once had. I have the same hopes and aspirations as the majority of the Cuban-Americans, though in contrast, I also sustain our domestic interests as an American. Gentlemen, as I close I will quote our Nobel Price winner, Milton Freeman: "Free Markets, Make Free Men . . ."

Chairman CRANE. Thank you, Ms. Alfonso.

Mr. Rangel.

Mr. RANGEL. Mr. Sanchez, is Jorge Mas Canosa the president or the chairman of your organization?

Mr. SANCHEZ. He is the chairman of the board.

Mr. RANGEL. Has he ever said that he would make himself available for the possible presidency of Cuba, if there were a free election?

Mr. SANCHEZ. He has never told it to me.

Mr. RANGEL. Have you heard——

Mr. SANCHEZ. I have never heard him say that.

Mr. RANGEL. Would he be, to the best of your knowledge, based on his relationship, a possible candidate?

Mr. SANCHEZ. I have no idea. I think that he is a great leader, myself. I would hope that the Cuban people think the same thing. But it is going to be their choice.

Mr. RANGEL. So it is possible?

Mr. SANCHEZ. Everything is possible.

Mr. RANGEL. In terms of getting rid of Castro, and the economic pressure that may increase on Cuba, do you see a possibility that there would be an armed struggle against Castro, and a peoples' revolt?

Mr. SANCHEZ. Yes. Again, everything is possible. I don't know what kind of a transition will take place. It would be nice if it was a peaceful transition. But what is needed is a radical transition from the system that exists there today. There is a very repressive system and that has to be taken care of.

Mr. RANGEL. If there was a peoples' revolt against Castro, do you think the United States should support those people who were involved in the struggle for their liberty and freedom?

Mr. SANCHEZ. I think the United States has supported freedom fighters all over the world. That is part of the history, the great history of this country, and I would expect that the United States will support anyone who is fighting for their freedom anywhere.

Mr. RANGEL. Would you support the introduction of American troops in support of the Cubans if it was needed and requested?

Mr. SANCHEZ. I don't have an answer for you. You raise an interesting question. If it is requested, I believe that the United States has a responsibility in this hemisphere to bring about democracy. I think the United States also has a responsibility to make sure that there is not a massacre of innocent people, and I think——

Mr. RANGEL. OK. So if the circumstances lend themselves to that, then you would. Back to Helms-Burton. Do you support that?

Mr. SANCHEZ. Absolutely.

Mr. RANGEL. Do you think there is any possibility that that would become the law of the United States?

Mr. SANCHEZ. I not only think it will become the law of the United States, I think it will have a great effect, as it is having already. I have received calls from attorneys representing people who are interested in investing, and have told me that they will not do it because they're now aware of the issue of the confiscated properties.

Mr. RANGEL. Sir, you're eloquent, you make a lot of sense, but I'm fighting the red light. Do you believe that the people that we

have treaties with, Mexico, Canada, the European common market, that we would be in a position to tell them and to dictate to them who their trading partners would be, under penalty that we would not accept any of their imports? Do you think that could work?

Mr. SANCHEZ. I think that that is an overstated point with regards to the Helms-Burton bill. I think that the teeth of the Helms-Burton bill is between, creates a conflict perhaps, between private citizens. Maybe Mr. Gutierrez' family, who owns the sugarmill, and somebody who seeks to invest in it, and he would have a Federal cause of action.

That is what is creating the greatest amount of concern.

Mr. RANGEL. Sir, listen. It says that the bill imposes U.S. law on other countries, it prohibits the importation of goods from third countries and denies visas to executive shareholders and families who do business with Cuba. Now, assuming that that is the law, do you really think that sovereign countries would abide by this?

Mr. SANCHEZ. I believe that sovereign countries like Canada should actually encourage it. In fact, Canada has a law very similar to that, that makes it illegal to possess stolen property. We're just merely——

Mr. RANGEL. You are getting to another claim. I am talking about trade, and you are talking about getting the property.

Mr. SANCHEZ. But the underlying reason for denying their visa is if they are dealing in stolen property.

Mr. RANGEL. I am not talking about the visa, I was talking about prohibiting the importation of goods.

Mr. SANCHEZ. I misunderstood you. I thought you mentioned the visa ban.

Mr. RANGEL. I just threw that in. That's among the other things. Do you really think that we will tell Japan, "You do business and you can't export to the United States."

Mr. SANCHEZ. There is no prohibition on the exporting of the United States. There is no prohibition on exporting your goods to the United States, there is a prohibition vis-a-vis sugar, and it is very limited to that one item. But if you do business in Cuba today, you are free to do business with the United States, and the Helms-Burton bill does not change that.

Mr. RANGEL. On the property issue would you believe that when we talk about property that was seized illegally, that compensation could be made in money, since so many countries have purchased this illegal property, and so many peasants have been given this illegal property, would you see within the framework of the transition that the property not actually have to be returned, but that the legal owners be compensated for the sale?

Mr. SANCHEZ. There is a twofold answer. With regard to the foreign investors, I believe their investment should be declared null and void. They did it knowingly, and they should lose their investment in Cuba. With respect to how you deal with properties in Cuba, and whether you provide restitution or compensation, I think it depends on the circumstances of the property. And that is something that will have to be devised by Cubans on the island, once they have a choice in deciding how to do it.

Mr. RANGEL. And if Jorge Mas Canosa does become a candidate, you would not hesitate to share that with me, would you?

Mr. SANCHEZ. Excuse me?
Mr. RANGEL. You would not hesitate to share with me if——
Mr. SANCHEZ. I'll call you immediately.
Mr. RANGEL. Thank you. Give him my best regards.
Mr. SANCHEZ. I will do that.
Mr. RANGEL. Thank you.
Chairman CRANE. Thank you.
Mr. Shaw.
Mr. SHAW. No questions.
Chairman CRANE. I have just one quick question remaining for Mr. Gutierrez. What were the hourly wages working in canefields in Cuba pre-Castro?
Mr. GUTIERREZ. $4.90 a day in 1958.
Chairman CRANE. And in adjusted dollars today?
Mr. GUTIERREZ. $4.90.
Chairman CRANE. That would be at least $25 today, in adjusted dollars?
Mr. GUTIERREZ. At least.
Chairman CRANE. That's interesting. How does a person survive down there on 25 cents a week?
Mr. GUTIERREZ. It's called the black market. It's called growing your own vegetables a few rows into the sugarcanefield, maybe tuber vegetables such as malanga or boniato, et cetera. That is why sugar cane production is so low, and that is why you are seeing this disastrous harvest. It is not because of the lack of petroleum or spare parts, although those are also problems, but it is basically because there is not enough sugar cane on the island.
People are not getting paid enough to have the incentive to grow it. And this is a new phenomenom in Cuba. In Cuba before Castro, sugar cane stayed and rotted in the fields because there was more than enough to fill Cuba's domestic and international commitments.
There were 161 sugarmills in Cuba, which are represented by our association, the National Association of Sugar Mill Owners of Cuba. Thirty-five of those mills were owned by American corporations at the time that they were confiscated. They are members of our association, as well.
Chairman CRANE. Now, I reflect back to the thirties, working at the farm, and there was heavy lifting, hot weather, and we received 10 cents an hour, and that was 10 hours a day.
Mr. GUTIERREZ. And at least, there was a possibility for upward mobility——
Chairman CRANE. There was, indeed.
Mr. GUTIERREZ. But that doesn't exist in Cuba.
Chairman CRANE. Yes, indeed. I thank all of you panelists.
Mr. RANGEL. Mr. Chairman.
Chairman CRANE. Yes.
Mr. RANGEL. Could I just follow through? Not that anyone wants the type of pricing like under Batista to come back, but generally speaking, would you think that life under Batista was better for the Cuban people than life under the dictator, Fidel Castro?
Mr. GUTIERREZ. Mr. Rangel, life under Batista did not affect the economic well-being of the vast majority of Cuban citizens. General

Batista was a dictator, he was corrupt, and he violated Cuba's consitutional rhythm under its 1940 constitution.

Mr. RANGEL. I said we wouldn't want him to return.

Mr. GUTIERREZ. No, we would not want him to return.

Mr. RANGEL. I just asked a question since we got two scoundrels that we're talking about.

Mr. GUTIERREZ. Yes, but one scoundrel is much more efficient. The second scoundrel is much more efficient at repression than the first.

Mr. RANGEL. No, no. Let's use their names. I asked a question, do you think that for Cubans that life was better off under Batista than under this tyrant Castro?

Mr. GUTIERREZ. Mr. Rangel, if you ask this to any Cuban on the island or in exile, they will give you an analogy to answer your question. They will tell you that General Batista was like a bad headache. In attempting to cure that headache, Cuba decapitated itself by having Mr. Castro take power. That gives you a relative accurate analogy.

Mr. RANGEL. Well, there's a job for you in our State Department.

Mr. GUTIERREZ. Thank you. I will take you up on that.

Chairman CRANE. Thank you, panelists, for your participation. And we would now like to call upon our last business panel, Hon. Otto Reich, president of U.S.-Cuba Business Council, Keith Broussard, vice chairman, USA Rice Federation, and John Kavulich. Did I pronounce that correctly? Mr. Kavulich, president, U.S.-Cuba Trade and Economic Council.

And our first witness, Hon. Otto Reich.

STATEMENT OF HON. OTTO J. REICH, PRESIDENT US-CUBA BUSINESS COUNCIL

Mr. REICH. Thank you, Mr. Chairman. I would like to summarize my remarks. I appreciate the opportunity to testify. As we've been hearing all day, Mr. Chairman, when political and economic conditions are appropriate, when freedom returns to Cuba, both political and economic, I have no doubt that the island will see an economic recovery unprecedented in the post-communist era.

American companies will contribute to and participate in an economic progress, but only if we are careful to ensure a level playingfield now. At first, we will encounter in Cuba a social and economic devastation of monumental proportions, of the sort that is normally associated with war.

Since communism was imposed in the early sixties, Cuba's socioeconomic indicators have declined consistently. In the fifties, Cuba was in the top three positions in the hemisphere in practically every level of measurement, from per capita income to income distribution, from high literacy rates to low mortality rates.

In the past 30 years Cuba has declined to levels similar to those of the poorest third of the hemisphere. In some cases, similar to Haiti's. Since 1989 alone, the economy has declined by half. Cuba's infrastructure is antiquated and crumbling. Telecommunications, electricity, housing, transportation, all will have to leap forward by 35 to 40 years, just to catch up with today's standards.

These opportunities represent, as I document in my testimony, several billions of dollars of business for U.S. exporters and inves-

tors. But as I said at the outset, only if the right conditions exist. We must ensure that we do not take any action today which would make it difficult for U.S. companies to participate equitably in Cuba's future economic recovery.

We must not give an unfair advantage to those foreign companies who are taking advantage of Castro's giveaway of the island's properties. Cuba today lacks the legal, commercial and financial structures which are necessary requirements for legitimate business operations.

Cuba is behind other communist countries such as China and Viet Nam in economic reforms. It has no commercial lending opportunities, bankruptcy laws or stock exchange. Unlike their Asian counterparts, Cuban authorities still control pricing and production methods for agriculture. Cuban workers are not allowed to enter into contracts with foreign companies.

Instead, the Cuban Government receives all of the worker's compensation, and in turn pays the Cuban worker at the official rate of 1 peso to the dollar, or approximately 2 percent of the real value of the worker's wages. All of which makes the much-ballyhooed foreign investment in Cuba today not only commercially unstable, but morally reprehensible.

International law recognizes that confiscation of domestic property for the purposes of ethnic or political retribution is "not law at all." The experience of former Soviet bloc regimes teaches us that protracted disputes over confiscated property impede trade and investment, increase commercial and legal risks, and delay economic development.

The settlement of property claims, however, is only one issue which will have to be addressed, and it must apply equally to foreign investors. Other issues include rule of law, contract sanctity and due process, secure money and capital repatriation, consistent and uniformly applied commercial laws, equitable and transparent tax structure, and internationally recognized labor rights.

Under the proper conditions of political and economic freedom, Cuba's economic potential is enormous. In spite of 36 years of communist inefficiency, Cuba still has a base of—a viable base of industry, including tourism, sugar, citrus, mining, tobacco and many others, which can and will attract foreign investment and fuel economic revival.

It is reasonable to expect that in the first year alone of renewed economic relations, some $4 billion of U.S.-Cuba trade would take place. Furthermore, a postcommunist Cuba would have many advantages in addition to proximity to the United States, which other postcommunist societies did not have. For example, the Cuban emigre community has a larger income than that of the entire island.

The total income of the roughly 1½ million Cuban-Americans is larger than the gross domestic product of Cuba. There are 65,000 Cuban-American businesses in south Florida alone, which can be expected to be a source of capital and technology. Estimates of remittances go from $400 million, which was the figure a couple of years ago, before they were cut off, to $1.2 billion in the first year of relations between the United States and a friendly Cuban Government.

U.S. direct investment in pre-Castro Cuba was roughly $3 billion. Taking into account population growth rates, and conservative economic growth, that figure today would be over $14 billion.

Finally, Mr. Chairman, there are many reasons to not do business with Cuba until the political and economic reforms are established and irreversible. In fact, to do so now would actually punish U.S. companies who have supported U.S. policy and complied with U.S. law.

Cuba cannot recover without access to the U.S. market, U.S. dollars and U.S. commercial credits. We should use our economic power to bring about the end of Cuban communism, just as it was used to end Soviet communism. We should not be concerned about European or Canadian or Mexican companies that may be making money. There is no money to be made in a country with a per capita income of $5 a month.

Those companies are the ones who should be concerned that collaboration with a totalitarian regime will preclude their participation in a democratic free market Cuba. Thank you.

[The prepared statement follows:]

TESTIMONY OF THE HONORABLE OTTO J. REICH
PRESIDENT, US-CUBA BUSINESS COUNCIL
Before the
COMMITTEE ON WAYS AND MEANS, SUB-COMMITTEE ON TRADE
US HOUSE OF REPRESENTATIVES
June 30, 1995

Mr. Chairman and Members of the Committee, thank you for giving me the opportunity to speak on the subject of the economic relationship between the United States and Cuba after Castro.

When democracy, respect for human rights and economic freedom prevail in Cuba and the U.S. embargo is lifted, what will we find when we enter the last business frontier in the Western Hemisphere? Initially, prospective investors will initially encounter an exceedingly bleak landscape:

Although information on the Cuban economy is very difficult to obtain, recent data from Cuban government sources offer a glimpse of the economic catastrophe on the island:

* Cuba's gross social product (a crude socialist equivalent of GDP), estimated at 10 billion pesos in 1994, has declined by more than half since 1989. Cuba's hard currency reserves have dwindled to less than $60 million and total export earnings last year barely reached $1.7 billion -- or less than Bangladesh.

* Cuba's budget deficit, fueled by state subsidies, totalled some 40 percent of GDP in 1993. Some 10 billion excess pesos in circulation continue to provide unrecognized inflationary pressures in the economy.

* Cuban officials acknowledge that industrial output has fallen to 15 percent of capacity and that nearly three-fourths of all state enterprises are money-losing operations with little prospect of profitability. Cuba's sugar industry, which still accounts for most of the island's hard currency earnings, has collapsed. The 1994-1995 sugar crop estimated at some 3.3 million tons is one-half of Cuba's 1958 output.

* Cuba's infrastructure will present several development nightmares for a transition regime in Cuba, including:

- an unreliable, antiquated communications system comprised of roughly 500,000 access lines (fewer than Washington D.C.) and no advanced mobile communications. US carriers, under the provisions of the Cuban Democracy Act, are now transmitting Miami-based calls to the island. However, given the extremely limited purchasing power of Cuban citizens (roughly $5 per month), significant development of the domestic telecommunications infrastructure will require a dramatic economic-political transformation on the island.

- A lack of reliable electrical power due to poor maintenance, dilapidated transmission systems, reliance on old generating units of Soviet bloc origin, and severe shortages of spare parts and fuel. Cuba's energy production has dropped more than 50 percent since 1991 [Cuba's current installed electric power generating capacity is less than 5000 MW]. The average Cuban household consumes in one month the amount of electricity which a U.S. house consumes in three days.

- A crumbling housing, sewage and transportation infrastructure. Cuba's water and sewage lines are 50-70 years old. More than 50 percent of water in the system is lost before reaching end users. Cuba's acute housing shortage will require construction of 200,000 single family residences to meet immediate needs. [The estimated modernization cost is over $2 billion].

- Inefficient and aging transport system. Maritime transport system relies on 11 major ports (current capacity 1 million DWT) which have not been upgraded in more than thirty years. There are no passenger terminal facilities in Cuba. Rail transport systems, primarily hauling bulk cargo at very slow speeds, are in very poor operational condition. Short-term renovation, fast-tracking and creation of a two tracks system through the core of the island would cost more than $2 billion. Passenger service is virtually non-existent. Cuba's inter-regional highway system is in fair condition but urban and mass transit systems are completely dysfunctional and would require some $500 million in operational improvements to meet basic transportation needs. Cuba has only some 200,000 functioning ground transportation vehicles on the island today.

- Lack of financial resources. Cuba's, meager hard currency earnings; an unserviced $8 billion debt to commercial and Paris Club creditors; and the absence of any commercial banks in Cuba provide a most inhospitable financial environment for business development.

* Cuba's Legal-Institutional Framework. Most importantly, a democratic, market-oriented regime in Cuba will be faced with the challenge of dismantling an established political economic system which presents overwhelming obstacles to economic development. The most important factor in assessing the potential impact of renewed US economic ties to such post-Soviet bloc nations is access to the domestic population. Once sanctions are lifted, do US firms have an avenue to expand commercial ties with the domestic population - rather than government officials - and promote economic liberalization? Can domestic citizens hire employees, start small businesses, invest in company stock, or deal directly with foreign investors as employees or contractors?

Unfortunately, in the case of Cuba, the answer in each instance is no. In fact, Cuba is light years behind China and Vietnam in implementing economic reforms. Unlike China and Vietnam, Cuba effectively prohibits the creation of any domestic small business operations. The Cuban government has no commercial lending operations, bankruptcy laws or a stock exchange. There are no majority-owned foreign enterprises. Direct participation by Cuban citizens in any foreign ventures is not permitted. Unlike their Asian counterparts, Cuban authorities have refused to loosen their grip on pricing and production controls for agricultural cooperatives. A democratic, market-oriented regime must move quickly to create a legal framework which facilitates Cuba's integration into the international economic community.

NECESSARY CONDITIONS FOR SUCCESSFUL COMMERCIAL ACTIVITY IN CUBA

Leveling the Playing Field for US Firms in a Democratic, Free Market Cuba. Make no mistake, when a stable, democratic and market-oriented Cuba opens the door to genuine economic development and commercial opportunity, US companies will be second to none in gaining access to a market of 11 million people only 90 miles from our shores eager to obtain familiar US-brand goods and services.

However, in order to avoid placing US companies at a disadvantage in relation to foreign firms that exploit confiscated property of US claimants and ignore their own environmental and labor laws to conduct business in Cuba, it is important to take action now to discourage such actions. Such exploitation by foreign firms undermines respect for fundamental property rights which are recognized by the US Constitution, the OAS Charter, the UN Declaration of Human Rights, the Cuban Constitution of 1940 (applicable at the time of confiscation of private property), and the North American Free Trade Agreement. Moreover, international law recognizes that confiscation of domestic property for the purposes of ethnic or political retribution "is not law at all."

The experience of former Soviet bloc regimes in Eastern Europe teaches us that protracted disputes over confiscated property in a free market, democratic Cuba would impede trade and investment, increase commercial and legal risks and delay economic development on the island.

Property Claims Resolution. The confiscation of properties owned by American companies and individuals in Cuba was a primary factor in the US decision to implement an embargo. US claims worth some $2 billion (in 1962 US$) represent the largest uncompensated taking of American property by any foreign government in the history of the United States. However, it is important to note that when conditions on the island warrant normalized US-Cuba relations, the value of having remedies in place to defend US property rights in Cuba will become even more apparent. US as well as foreign firms will face a hostile commercial environment on the island if no legal recourse exists to effectively resolve outstanding property disputes.

Property claims resolution in Germany, the Czech Republic and other post-Soviet bloc nations, which relied upon restitution of property as well as compensation for claimants, cannot be applied to the case of Cuba because the current Cuban government has not established a legal-institutional framework to protect ownership of private property in any form. Similarly, the recent "resolution" of Spanish claims against the Cuban government provides no viable model for US claimants. The Spanish government rejected many claims and compelled the lucky few who were certified to accept a few pennies on the dollar. Moreover, Cuba did not pay compensation. Spain had to come up with the money up front and hope that the Cuban government would pay them back at some time in the future.

As I mentioned earlier, the settlement of property claims and protection of property rights (including equal protection among Cuban and foreign investors and clear legal title to assets) is an essential, but not by any means the only, issue which will have to be dealt with in order for U.S. companies to develop successful trade and investment opportunities in Cuba. A transition regime in Cuba will need to rapidly establish institutional and economic reforms such as:

* Rule of Law, Contract Sanctity and Due Process facilitating the entrenchment of structural reforms and limiting the commercial and political risks of trade with Cuba.

* Secure Money and Capital Repatriation (including free convertibility of currency at market rate of exchange).

* Consistent and Uniformly-applied Commercial Laws.

* An Equitable and Transparent Tax Structure (competitive with tax costs in other countries in the Caribbean and Latin America.

* Basic Labor Rights (including fair employment practices and the hiring of employees independent of government control).

CUBA'S ECONOMIC POTENTIAL

Despite the formidable challenges which will confront a new leadership in Cuba there is ample reason to believe that, if the proper conditions are created, Cuba will rapidly become a leading economic performer in the Western Hemisphere. Living standards for Cuban citizens will improve dramatically and commercial opportunities for US firms will exceed those in any other country in the region.

One need only recall that pre-Castro Cuba was in the top three in per capita GNP and socio-economic indicators in Latin America. And more than 50 percent of Cubans on the island are in their peak productivity years between the age of 15 and 45. Cuba still has a base of viable industries, including tourism, sugar, citrus, mining and tobacco which can attract foreign investment and fuel economic revival.

For example, Cuba is well-positioned to capture a significant share of the $9 billion annual tourist trade in the Caribbean. According to estimates [from MarketScope a Miami-based research firm], US cruise ship companies could expect more than 500,000 passengers in the first year of an opening in Cuba, rising to 2.4 million cruise ship passengers annually within ten years. Tourism revenues in the first year of a free Cuba are likely to exceed $1 billion.

The bright economic prospects of a free Cuba are enhanced by several other key factors:

- U.S.-Cuba Trade. Throughout the post-WWII era, the U.S. accounted for roughly 70 percent of Cuba's total imports and exports. Proximity and a history of close trade ties with the world's largest market will have a profound impact on a free Cuba. U.S. producers of grain, processed foods, agricultural chemicals, construction supplies medical equipment and many other products will have a distinct competitive advantage over foreign producers. Many US firms will benefit from brand name awareness and knowledge of the Cuban market derived from commercial activity in pre-Castro Cuba.

It is reasonable to expect total U.S.-Cuba trade turnover -- excluding tourist trade -- could reach some $4 billion in the first year of renewed economic relations -- or roughly one-quarter of Cuba's 1989 world trade total.

- Foreign Investment and Capital Flows. The rate of foreign investment in a free Cuba will be strongly influenced by several factors including: the pace of property claims resolution, legal reforms to protect contract sanctity and due process, monetary and fiscal policy changes and the ability of firms to repatriate capital. However, Cuba has unique advantages not shared by other former Soviet bloc transition economies.

First, Cuban exiles, representing some 15 percent of the Cuban population, will provide a significant catalyst for economic growth. Even if one accepts the Cuban government artificial one-to-one peso\dollar exchange rate, the total income of the roughly 1.4 million Cuban-Americans is larger than the gross domestic product of Cuba.

Cuban-Americans provided an estimated $400 million in remittances to Cuban citizens in 1993. A conservative estimate of such remittances to a free Cuba is $1.2 billion, or twice the level of Dominican and Jamaican expatriates to their homelands. In addition, many of the more than 65,000 Cuban-American businesses in the South Florida-area will provide direct investment in a free Cuba to establish new businesses on the island.

US Direct Investment. Cuba's proximity to the US and the history of US investment in the pre-Castro era suggests that total foreign direct investment in a free Cuba will dwarf that of other former Soviet bloc nations. The roughly $3.27 billion in foreign direct investment in (1957) pre-Castro Cuba equals roughly $14 billion in 1990 dollars. And U.S. investors will have plenty of opportunities in Cuba when they gain access to the Cuban market.

- GNP Growth. Several recent studies on Cuba have used Caribbean or Central American countries as a benchmark for Cuba's economic performance. I believe that this provides a distorted view of the island nation's potential. A more accurate preview of Cuba's performance would be Chile, a nation with similar demographic characteristics which has significant natural and human resources and a rapidly rising GNP totalling $31 billion in 1993. Similarly, Cuba's 1957 export earnings of $845 million were roughly comparable to those of Argentina ($975 million).

WHAT CAN WE DO TO PROMOTE THE ECONOMIC REVIVAL OF A FREE CUBA?

How can the U.S. business community as well as U.S. and multilateral development agencies help foster economic revival in a free, democratic Cuba?

I. Encourage Macro-Economic Reform in Cuba. No amount of financial assistance can foster an economic revival in Cuba unless fundamental monetary, fiscal and trade policy reforms are implemented and a new legal-institutional system is established. In fact, as Mexico's recent peso crisis amply demonstrates, irresponsible government spending and monetary policies by countries in the region can have a direct, negative impact on the health of the US economy.

Given Cuba's lack of cash, weak foreign exchange earnings and proximity to the US, a new leadership in Cuba will have a tremendous incentive to look to the world's largest economy and the Cuban exile community to forge a mutually beneficial relationship based on open markets, political pluralism and economic opportunity. As the experience of the former Soviet Union indicates, protracted delays in the implementation of legal-institutional reforms, privatization programs and a stable currency have a devastating impact on the most vulnerable elements of the domestic economy.

II. Remove US-Cuba Trade Barriers. U.S. trade policy will be a crucial factor in the development of Cuba's export-driven economy. Once a democratic government is in place in Cuba, we will need to move quickly on a bilateral framework agreement on key trade issues and the accession of Cuba to the NAFTA or a separate free trade agreement.

Traditionally, the US government utilizes bilateral business organizations to encourage dialogue between government and private sector representatives and to identify key trade concerns. Here, US trade promotion programs and private organizations like the US-Cuba Business Council can play an important role in building the foundation for a mutually beneficial US-Cuba free trade regime. Similarly, trade groups and other non-governmental organizations can play a vital role in educating Cuban citizens about the nature of the free enterprise system and the development of commercial, political and civic institutions which underpin a stable and prosperous society.

III. Provide Assistance to a Democratic Market-Oriented Cuba. Title II of the LIBERTAD Act establishes a comprehensive strategy for assisting a transitional and democratic regime to foster economic development and promote commercial opportunities for US businesses. By establishing specific conditions for the resumption of US trade and assistance programs to a future Cuban government -- including respect for human rights, free elections, constitutional changes and market-oriented reforms we can encourage movement toward democracy on the island and the subsequent development of mutually beneficial economic ties. Such measures also will remind the current Cuban government of its obligations under international law on issues such as labor freedom, property claims and other key concerns.

Humanitarian assistance. Humanitarian aid, trade and assistance, and educational programs contained in the LIBERTAD Act send a clear signal to the Cuban people that the US is prepared to assist in the revival of Cuba's shattered economy and to build a mutually beneficial bilateral relationship.

Executive Branch agencies such as US AID and the Defense Department could provide a timely and important contribution to US-Cuba policy by immediately developing plans for emergency assistance to a transitional government in Cuba and submitting reports to the appropriate congressional committees as soon as possible. Such reports could provide guidance on key issues such as: coordination of private voluntary organizations to assist in the operation of emergency relief programs; use of military transport and logistical support in executing US programs; the role of Cuban-American community groups in mobilizing relief and technical assistance programs; facilitating US business involvement in Cuba's reconstruction; focusing U.S. aid on crucial industrial needs (including sugar refining equipment, farm machinery, fertilizer, oil and spare parts); and strategies for accelerating U.S. funding and delivery of aid programs.

Chairman CRANE. Thank you, Mr. Reich.
Mr. Broussard.

STATEMENT OF KEITH BROUSSARD, VICE CHAIRMAN, USA RICE FEDERATION

Mr. BROUSSARD. Good afternoon, Mr. Chairman. I am chairman of the Rice Millers Association and vice chairman of the USA Rice Federation. I appear here on behalf of the USA Rice Federation.

The USA Rice Federation is the national trade association of the U.S. rice industry, and works to advance the common interests of this country's rice producers, millers, marketers, and other industry segments. The federation is composed of three charter members, USA Rice Producers Group, the USA Rice Council, and the U.S. Rice Millers Association.

Trade has historically been and will continue to be critical to the U.S. rice industry. The United States exports roughly half of the rice it produces, and is the second leading exporter of rice in the world. The U.S. share of world rice trade has ranged from 16 to 28 percent. In 1994, the United States held a 17 percent share of world trade. The U.S. industry's largest global competitor is Thailand, which maintains an average market share of about 35 percent.

Today, U.S. rice is sold in over 110 countries, and is widely recognized for its quality. The United States is also considered a reliable diversified supplier, exporting both long and medium grain types of rice, with a wide range of processing. Current major export destinations for the United States include the European Union, Mexico, Saudi Arabia, Turkey, Haiti, and South Africa.

Japan recently began importing large quantities of U.S. rice on an emergency basis, and was one of our largest import markets in 1994. In addition, the U.S. rice industry is working to develop markets in other countries that have provided greater market access under the Uruguay round agreement.

The rice industry is often affected adversely by geopolitical constraints on trade. For example, before President Clinton's recent Executive order on the U.S. trade embargo with Iran, that country was emerging as one of the largest markets for high-quality U.S. rice. Between August 1994 and May of this year, registered U.S. exports and outstanding sales to Iran totaled 291,000 metric tons, nearly 23 percent of Iran's projected total imports, according to USDA reports.

The Iran scenario of 1995 has its counterpart in the Cuba of 1960. At one time, Cuba was the largest single importer of U.S. rice, preferring to buy the U.S. product because of quality, proximity and reliable supply. Cuba purchased U.S. rice on a commercial basis. In 1951 Cuba imported a peak volume of approximately 250,000 tons of U.S. rice, which represented about half of the total U.S. exports at that time. In 1993, a 250,000-ton market of U.S. rice would have accounted for approximately 9 percent of our total exports.

The type of rice purchased by Cuba from the United States was a high quality U.S. long grain product. In the years since the embargo, Cuba has imported a lower grade product both long and medium grain. The U.S. rice industry believes once the U.S. Govern-

ment has lifted the embargo, Cuba will again become a significant market for U.S. rice.

Because of the structural changes that have occurred in Cuba, and changing food consumption patterns, it is possible that a postembargo Cuba may not immediately be in a position to commercially import the same high quality U.S. rice it has in the past. However, the U.S. rice industry views the Cuban market as one of great potential.

Once the embargo is no longer in place, the U.S. industry will expect to reenter the Cuban market and work closely with the U.S. Government to make use of any government programs which may assist in maximizing potential gains in this important market.

Mr. Chairman, I thank you for the time to have my comments.

[The prepared statement follows:]

HOUSE WAYS & MEANS SUBCOMMITTEE ON TRADE HEARING ON THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CUBA AFTER CASTRO

STATEMENT

USA RICE FEDERATION

JUNE 30, 1995

Good morning Mr. Chairman, my name is Keith Broussard. I am Chairman of The Rice Millers' Association (RMA) and Vice Chairman of the USA Rice Federation. I appear here this morning on behalf of the USA Rice Federation. USA Rice Federation is the national trade association of the U.S. rice industry and works to advance the common interests of this country's rice producers, millers, marketers and other industry segments. The Federation is composed of three charter members -- the U.S. Rice Producers Group, the USA Rice Council and the Rice Miller's Association.

U.S. Rice Trade

Trade has historically been, and will continue to be, critical to the U.S. rice industry. The U.S. exports roughly half of the rice it produces, and is the second leading exporter of rice in the world. The U.S. share of world rice trade has ranged from 16 percent to 28 percent. In 1994, the U.S. held a 17 percent share of world trade. The U.S. industry's largest global competitor is Thailand, which maintains an average market share of about 35 percent. Today, U.S. rice is sold in over 110 countries and is widely recognized for quality. The U.S. is also a considered a reliable, diversified supplier, exporting both long and medium grain types of rice with a wide range of processing.

Current major export destinations for U.S. include the European Union (EU), Mexico, Saudi Arabia, Turkey, Haiti and South Africa. Japan recently began importing large volumes of U.S. rice on an emergency basis and was one of our largest import markets in 1994. In addition, the U.S. rice industry is working to develop markets in other countries that have provided greater market access under the Uruguay Round agreement.

The U.S. Rice Industry and Global Trade Issues

The U.S. rice industry is often affected adversely by geopolitical constraints on trade. For example, before President Clinton's recent executive order on the U.S. trade embargo with Iran, that country was emerging as one of the largest markets for high quality U.S. rice. Between August of 1994 and May of this year, registered U.S. exports and outstanding sales to Iran totaled 291,000 metric tons, nearly 23% of Iran's projected total imports, according to USDA reports. Although these transactions can be fulfilled under "general license," the trade embargo will allow other producing nations such as Thailand and Vietnam to gain major competitive advantages over the U.S. rice industry in the future.

U.S. and Cuba Rice Trade

The Iran scenario of 1995 has its counterpart in the Cuba of 1960. At one time, Cuba was the largest single importer of U.S. rice, preferring to buy the U.S. product because of quality, proximity and reliable supply. Cuba purchased U.S. rice on a commercial basis. In 1951, Cuba imported a peak volume of approximately 250,000 tons of U.S. rice which represented about half of total U.S. exports at the time. In 1993, a 250,000 ton market for U.S. rice would have accounted for approximately 9 percent of total exports.

Cuba's share of total U.S. exports varied considerably from year-to-year, ranging from 17 to 51 percent in the ten-year-period prior to the embargo in 1960. Also, in the ten-year-period prior to the embargo Cuba's rice imports appeared to be on a declining trend because of domestic production expansion. Since the embargo, Cuba's annual imports have averaged around 200,000 tons, with primary import origins of Thailand and China.

The type of rice purchased by Cuba from the U.S. was a high quality U.S. long grain product. In the years since the embargo, Cuba has imported a lower grade product, both long and medium grain.

The U.S. rice industry believes once the U.S. government has lifted the embargo, Cuba will again become a significant market for U.S. rice. Because of the structural changes that have occurred in Cuba and changing food consumption patterns, it is possible that a post-embargo Cuba may not immediately be in a position to commercially import the same high quality U.S. rice it had in the past. However, the U.S. rice industry views the Cuban market as one of great potential. Once the embargo is no longer in place, the U.S. industry will expect to re-enter the Cuban market and will work closely with the U.S. government to make use of any government programs which may assist in maximizing potential gains in this important market.

Chairman CRANE. Thank you. Sir, if you would please proceed.

STATEMENT OF JOHN S. KAVULICH II, PRESIDENT, U.S.-CUBA TRADE AND ECONOMIC COUNCIL, INC.

Mr. KAVULICH. Mr. Chairman and members of the subcommittee, thank you for this opportunity to appear and discuss the interest by the U.S. business community toward the reemerging market of the Republic of Cuba.

I represent the U.S.-Cuba Trade and Economic Council, the largest nonpartisan not-for-profit membership-based business organization in the United States, which focuses on Cuba. Our membership ranges from some of the largest public and private corporations to individual entrepreneurs and businesses from other countries.

The future value of market Cuba to the U.S. business community can most objectively be understood by providing information about the previous and current levels of interest toward the country.

Between 1980 and 1992, the value of U.S.-owned foreign subsidiaries' trade licensed by the Department of the Treasury exceeded $4 billion. Of the more than 100 U.S. parent companies involved with this trade, many have commercial claims for expropriated property in Cuba. Since 1992, many of these same companies have continued to engage in opportunities with Cuban enterprises, which are authorized under provisions of the Cuban Democracy Act and Berman amendment.

In 1992, less than 200 representatives of the U.S. business community visited Cuba. In 1994, more than 500 visited the country. This year, the numbers have doubled for the same periods from last year, and the number of general aviation aircraft from throughout the world landing at Jose Marti International Airport in Havana have increased dramatically.

Those representatives of U.S. businesses who do visit Cuba do so under the auspices of regulations administered by the U.S. Department of the Treasury. Some of the commercial activities which are permitted, many due to provisions, again, of the Cuban Democracy Act and Berman amendment include the following: First, execute and implement contracts within the fields of artwork, communications, entertainment, medical equipment, medical instruments, medical supplies, pharmaceutical, publishing and telecommunications. Second, execute nonbinding letters of intent. Third, make donations for humanitarian purposes. Fourth, register trademarks and patents. There has been a rapid increase in the number of U.S. businesses which are registering their trademarks and patents with the Chamber of Commerce in Cuba.

No one wishes a repeat of today's events in South Africa, where among other companies, McDonald's, Toys-R-Us, and Victoria's Secret have lost the rights to their trademarks, and must now incur hundreds of thousands of dollars in court-related costs in attempts to get them back.

Fifth, charge cards and credit cards may be valid for use in Cuba. Sixth, travel services may be provided; seventh, air transportation may be provided. And last, U.S. companies and individuals subject to U.S. law may have indirect, noncontrolling investments in third-country companies, which have commercial dealings today in Cuba.

The value of unrestricted annual U.S.-Cuba trade has been estimated to range from a low of $2 billion to a high of $6 billion, with perhaps 70 percent of the annual value being exports from the United States. According to the U.S. Department of Commerce, for each $1 billion in U.S. exports, 20,000 new employment opportunities can be created. Thus, U.S.-Cuba trade could be responsible for creating anywhere from 40,000 to 120,000 new jobs from throughout many of the 435 congressional districts in the United States.

Which U.S. businesses will export to or import from, or provide services for the people of Cuba? Perhaps Kemper Insurance and Motorola from Chairman Crane's district. Currently, Motorola cellular telephones are the product of choice for users of the cellular network in Cuba.

Or Dow Chemical from Representative Camp's district, or Corning and Dresser from Representative Houghton's district,or Cargill from Representative Ramstad's district. Or Bristol-Meyers Squibb, Merck & Co., and Johnson & Johnson from Representative Zimmer's district. Or Packard Bell and Blue Diamond from Representative Matsui's district.

Dwayne Andreas, the chairman and chief executive officer of Archer Daniels Midland Co., the $11-billion agribusiness giant, which is also headquartered in Chairman Crane's State, said the current Republic of Cuba market could be a several hundred million dollar per year export and import opportunity for his company.

Lee Iacocca, the former chairman and chief executive officer of Chrysler Corp., who visited Cuba last year, has spoken of the value to the U.S. business community and consumers in having access to the Republic of Cuba market. Curtis Carlson, chairman and chief executive officer of Carlson Cos., a $10-billion travel and hospitality giant, looks forward to opening Radisson Hotels, T.G.I. Friday's restaurants, and travel agencies from Havana to Santiago de Cuba.

Ronald Perelman, chairman and chief executive officer of McAndrews and Forbes, the holding company for Consolidated Cigar, Coleman Camping Equipment and Revlon, among other companies, has discussed his interest in developing opportunities.

There are 11 million consumers 90 miles from Key West, Fla., who can today identify and who today prefer Nike, IBM, Mars, Coca-Cola, Visa, Ford, and General Electric, among many others. The commercial and economic transitions within Cuba have begun, and the scope of these changes continues to increase.

The U.S. business community will continue to increase its interest toward Cuba at a comparable speed. The goals of the U.S. business community are simple: Continue to work within the provisions of the Cuban Democracy Act and Berman amendment in order that competitive positioning can be developed, then maintained, and then expanded to achieve a profitable return to Havana, Santiago de Cuba, Cienfuegos, and all of the other cities and towns of Cuba. Thank you.

[The prepared statement follows:]

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Statement
of

John S. Kavulich II
President
U.S.-Cuba Trade and Economic Council, Inc.

Before the

Subcommittee on Trade
of the
Committee on Ways and Means
United States House of Representatives

30 June 1995

Mr. Chairman and members of the Subcommittee, thank you for this opportunity to appear and discuss the interest by the United States business community towards the re-emerging market of the Republic of Cuba.

I represent the U.S.-Cuba Trade and Economic Council, the largest nonpartisan, not-for-profit, membership-based business organization within the United States which focuses upon the Republic of Cuba. Our membership ranges from some of the largest public and private corporations to individual entrepreneurs and businesses from other countries.

The future value of "MarketCuba" to the United States business community can be most objectively understood by providing information about the previous and current levels of interest towards the country.

Between 1980 and 1992, the value of United States-owned foreign subsidiaries' trade, licensed by the United States Department of the Treasury, with enterprises within the Republic of Cuba was US$4.563 billion. Of the more than 100 United States parent companies involved with this trade, many had and continue to have commercial claims for expropriated property. Since 1992, many of these same companies have continued to engage in opportunities with Republic of Cuba enterprises which are authorized under provisions of the Cuban Democracy Act and Berman Amendment.

According to media reports, a growing number of United States companies which have commercial claims are discussing methods- such as debt-for-equity swaps, by which issues could be resolved before United States-Republic of Cuba commercial, economic, and political relations are once again normalized. A reason for placing a higher current priority on seeking resolution to claims issues is simple: no company wishes to be encumbered by any constraints and delays which their competitors within the United States and, more importantly today, their non-United States competitors would not be subjected to following a resumption of unrestricted bilateral commercial activities. As members of this Subcommittee are probably aware, the Government of the Republic of Cuba has settled its commercial claims issues with other countries; and has acknowledged its obligation to provide restitution for the value of expropriated assets. Under international law, an expropriated asset itself need not be returned, but a fair value of the expropriated asset must be provided to the claimant.

U.S.-Cuba Trade and Economic Council, Inc.

In 1992, less than 200 representatives of the United States business community visited the Republic of Cuba. In 1994, more than 500 visited the country. This year, the numbers have doubled for the same periods as last year- and the number of general aviation aircraft from throughout the world landing at Jose Marti International Airport in Havana has increased dramatically.

These numbers are only estimates- with the Republic of Cuba having relaxed entry procedures for tourists and business representatives, the reality is far many more people are visiting the country unannounced. One official of the Government of the Republic of Cuba has offered that the actual number of visitors from the United States may have exceeded 12,000 in 1994- including business visits, journalist visits, family visits, academic visits, and visits by members and staffs of the United States Congress.

Those representatives of United States businesses which have, or are, or plan to visit the Republic of Cuba, do so under the auspices of regulations administered by the United States Department of the Treasury's Office of Foreign Assets Control. Some of the commercial activities which are permitted (many due to provisions within the Cuban Democracy Act and Berman Amendment) include:

1) Execute and implement contracts within the fields of artwork, communications, entertainment, medical equipment, medical instruments, medical supplies, pharmaceutical, publishing, and telecommunications.

2) Execute non-binding letters of intent.

3) Make donations for humanitarian purposes.

4) Register trademarks and patents. There has been a rapid increase in the number of United States businesses which are registering their trademarks and patents with the Chamber of Commerce of the Republic of Cuba. No one wishes a repeat of events in today's Republic of South Africa where, among other companies, McDonald's, Toys 'R' Us, and Victoria's Secret lost the rights to their trademarks and must now incur hundreds of thousands of dollars in court-related costs.

5) Authorize consumer charge cards and consumer credit cards to be valid for use.

6) Provide travel services.

7) Operate air transportation.

8) Have indirect non-controlling investments in third country businesses which have commercial dealings with enterprises within the Republic of Cuba.

The value of unrestricted annual United States-Republic of Cuba trade has been estimated to range from a low of US$2 billion to a high of US$6 billion- with, perhaps, 70% of the total annual value being exports from the United States to the Republic of Cuba. According to the United States Department of Commerce, for each US$1 billion in United States exports, 20,000 new employment opportunities can be created. Thus, United States-Republic of Cuba trade could be responsible for creating 40,000 to 120,000 new jobs for citizens from throughout many of the 435 Congressional Districts.

Of interesting note is the fact that United States exports to the People's Republic of China in 1994 were estimated at US$6 billion- for a country of more than 1 billion people- quite a comparison considering that the Republic of Cuba has 11 million people and a potential export value nearly equal that of the largest country in the world.

Which United States businesses will export to, or import from, or provide services to the people of

the Republic of Cuba? Perhaps, Kemper Insurance and Motorola from Chairman Crane's district. Currently, Motorola cellular telephones are the product of choice for users of the cellular network within the Republic of Cuba. Or, Dow Chemical from Representative Camp's district. Or, Corning and Dresser from Representative Houghton's district. Or, Cargill from Representative Ramsted's district. Or, Bristol-Myers Squibb, Merck & Company, and Johnson & Johnson from Representative Zimmer's district. Or, Packard Bell and Blue Diamond from Representative Matsui's district.

Mr. Dwayne Andreas, Chairman and Chief Executive of Archer Daniels Midland Company, the US$11 billion agribusiness giant (also headquartered in Chairman Crane's state), said the current Republic of Cuba market could be a several hundred million dollar per year export and import opportunity. Mr. Lee Iacocca, former Chairman and Chief Executive Officer of Chrysler Corporation, who visited the Republic of Cuba in 1994, has spoken of the value to the United States business community and consumers in having access to the island's growing market.

Mr. Curtis Carlson, Chairman and Chief Executive Officer of Carlson Companies, the US$10 billion travel and hospitality giant, looks forward to opening Radisson Hotels, T.G.I. Friday's restaurants, and travel agencies from Havana to Santiago de Cuba. Mr. Ronald Perelman, Chairman and Chief Executive Officer of McAndrews and Forbes, the holding company for Consolidated Cigar, Coleman Camping Equipment, and Revlon, among other companies, as discussed his interest in developing opportunities.

There are 11 million consumers 90 miles from Key West, Florida, who can today identify and who today prefer Nike, IBM, Mars, Coca-Cola, Visa, Ford, and General Electric among many other United States-created brand names. For these companies and the others, one of the most significant costs associated with developing a new market- or, in this case, re-developing a previous market, is to create brand awareness and brand preference. In the Republic of Cuba, these costs most certainly will not be necessary.

The commercial and economic transitions within the Republic of Cuba have begun- and the scope and pace of these changes continues to move rapidly. The United States business community will continue to increase its interest towards the Republic of Cuba at a comparable speed. The goals of the United States business community are simple: continue to work within the provisions of the Cuban Democracy Act and Berman Amendment in order that competitive positioning can be developed, then maintained, and then expanded to achieve a profitable return to Havana, Santiago de Cuba, Cienfuegos, and all of the other cities and towns in the Republic of Cuba.

Thank you.

Chairman CRANE. We also have a statement to be inserted into the record from Eric Rodriguez, member of the board of directors of the Bridge of Young Cuban Professionals.

Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. Ambassador Reich, first let me thank you for the great contributions you made for our country to Venezuela, as well as international organizations, and continue to do so.

Second, the statement you made, is that on behalf of the Council, or is that your personal statement?

Mr. REICH. That's my personal statement, sir.

Mr. RANGEL. You know that most U.S. State Department people have positions dealing with Cuba that don't agree with you?

Mr. REICH. No, I don't. As a matter of fact——

Mr. RANGEL. Secretary Kissinger, Secretary Eagleburger, Assistant Secretary of State Bernie Aronson, they believe it's not in our national interest to——

Mr. REICH. Well, I have spoken with several of those, including Secretary Eagleburger and Bernie Aronson recently, and although they differ on some of the aspects, I think they do agree that the best way to bring about democracy in Cuba is to continue current U.S. policy. Certainly not to lift the embargo along the lines of your recommendations.

Mr. RANGEL. Well, they may not agree with my recommendations, but they certainly want that embargo removed. They don't believe it's in our national interest. They've written articles about it.

But since it's your view, and you used the name of the council, what is the council's view? Is it anybody with you on the council?

Mr. REICH. The council's mission statement, is that the best hope for U.S. business, as I mentioned in the statement, is a free and democratic Cuba, which I understand, obviously, by the title——

Mr. RANGEL. Well, we all want a free and democratic Cuba. I'm talking about with your groups and your council, are there people that—does your entire group support the embargo? And what percentage of your council members support the embargo?

Mr. REICH. All of our members support current U.S. policy, Mr. Rangel.

Mr. RANGEL. That's the embargo, isn't it?

Mr. REICH. All of our members support current U.S. policy, Mr. Rangel, including all aspects of current U.S. policy. I mean, they're all law-abiding citizens.

Mr. RANGEL. Listen, I'm with that. How about Helms-Burton? Does your council take a position on Helms-Burton?

Mr. REICH. We have not taken a position, because——

Mr. RANGEL. What's your position?

Mr. REICH. My position is that Helms-Burton will accelerate the process for change in Cuba.

Mr. RANGEL. And your council has taken an official vote on this? Because I was given bad information that they're all over the lot.

Mr. REICH. No, we have asked the council members, many of whom have not taken a position. They say they don't want to take a position on pending legislation on this issue, any more than——

Mr. RANGEL. No, no, no. I'm talking about existing policy. I understood that your members are all over the lot on that.

Mr. REICH. They support—all of the council members signed onto a mission statement that says they support current U.S. policy on Cuba designed to foster a democratic change with guarantees of freedom and human rights under the rule of law.

Mr. RANGEL. OK. Mr. Broussard, I never felt more proud as an American to hear you with such pride talk about the quality of rice and our position as it relates to the foreign trade. I mean, we're struggling to gain back our leadership, but it looks like rice is way ahead of the rest of our exports. Where does Cuba get its rice?

Mr. BROUSSARD. From Thailand and China, mostly.

Mr. RANGEL. Well, I don't have to talk about distance and transportation. Could you do me a favor and help me to pull together U.S. chicken producers, or U.S. bean producers, and our U.S. rice producers? Would you be kind enough to do that?

Mr. BROUSSARD. We will attempt to do that.

Mr. RANGEL. I'd like to have them meet with certain Members of Congress and go over this about how much we're losing, and whether or not just having food and medicine removed from this—do you think food and medicine, Ambassador, just those two items from the embargo, would adversely affect this foreign policy? Just food and medicine?

Mr. REICH. Sir, the problem in food and medicine, as well as, say, rice or chickens or anything else, the problem is not making them available. Castro can buy food and medicine today from any source. The problem is he doesn't have the money.

Mr. RANGEL. OK, great. If he doesn't have the money, he can't buy it.

Mr. REICH. But that goes to the crux of your question. Credits. The moment that the embargo is altered the way that the Cuban Government would like it to be altered, the Cuban Government will be right up here asking for credits from the American taxpayer.

Mr. RANGEL. So you oppose it. Mr. Kavulich, your organization, what percentage of your organization supports present policy and supports the embargo?

Mr. KAVULICH. In somewhat echoing Mr. Reich's remarks, all the members of the U.S.-Cuba Trade and Economic Council support whatever is the current law. Now, individually, some of them are very vocal in opposing U.S. law, and others are on the opposite side. Some would like to strengthen it. But the council itself does not take any positions whatsoever. We leave it to the members to do whatever they want to do.

Mr. RANGEL. And some of the members would want the embargo removed?

Mr. KAVULICH. I'd say if you're asking me to give you a percentage of the members, I would say probably close to all of them are supportive of being able to return without any restrictions to the Cuban market as soon as possible.

Mr. RANGEL. OK. Thank you, Mr. Chairman.

Chairman CRANE. Thank you.

Mr. Shaw.

Mr. SHAW. Just very briefly, Mr. Chairman. Mr. Kavulich, who belongs to your organization? Can you give me or give this committee a list of the members of your organization for whom you speak?

Mr. KAVULICH. The U.S.-Cuba Trade and Economic Council does not make its membership list public, and that is the decision of the members, and the reasons being are for competitive reasons.

Mr. SHAW. Do you have the authority to give us any members of your organization?

Mr. KAVULICH. No, sir. That's up to the members themselves.

Mr. SHAW. You mentioned T.G.I. Friday's and several others. Are they members of your organization?

Mr. KAVULICH. The context in which the individuals and the companies I mentioned here are from media reports, from stories, et cetera. Mr. Andreas was interviewed on CNN.

Mr. SHAW. Did any of them express a desire to go into Castro-governed Cuba?

Mr. KAVULICH. Well, Mr. Andreas, who was interviewed in Time magazine——

Mr. SHAW. I know Mr. Andreas. He's a constituent of mine.

Mr. KAVULICH. And he very forcefully has presented his belief that current U.S. policy is not the most effective way by which a change in the commercial, economic and political structures of Cuba, within Cuba, may be achieved in a most effective way.

Mr. SHAW. To be fair to Mr. Andreas, did he say that he thought we should open up trade with Cuba?

Mr. KAVULICH. Yes, he has.

Mr. SHAW. He has said that?

Mr. KAVULICH. As a matter of fact, his particular remark with respect to that was he quoted his father, who said that his father had often said to him that, "Son, when you're in a hole, stop digging." And his belief was that U.S. policy has been in a hole, and it's about time to change. And I can certainly give you a transcript of his remarks as he appeared on CNN.

Mr. SHAW. Well, I would appreciate seeing that, but he has not authorized you to speak for him?

Mr. KAVULICH. And I am not. I am merely——

Mr. SHAW. And you've never discussed anything directly with him? As a matter of fact, you've never met him, or talked to him, have you?

Mr. KAVULICH. Oh, yes, I have.

Mr. SHAW. You have?

Mr. KAVULICH. I appeared on CNN sitting next to him.

Mr. SHAW. Oh, so you are—you have first hand knowledge, then, of what——

Mr. KAVULICH. Yes, sir.

[The following was subsequently received:]

This transcript has not yet been checked against videotape and cannot, for that reason, be guaranteed as to accuracy of speakers and spelling. (JPM)

INSIDE BUSINESS Transcript #265
Air Date: June 3, 1995

The U.S. Embargo Against Cuba

DEBORAH MARCHINI, CNN Business News: *[voice-over]* Fidel Castro is showing even old dictators can learn new tricks. He's cutting loopholes in communism by cutting deals with hundreds of companies around the world to pump capital into his impoverished country. But the United States is not letting its companies play, insisting a economic embargo is needed to topple Castro's government. But is the embargo working, and whom does it punish, Cuban communists or American capitalists?

ANNOUNCER: This is Inside Business, with Deborah Marchini.

DEBORAH MARCHINI: Welcome to Inside Business. The U.S. economic embargo against Cuba is 34 years old, and Republicans in Congress want to strengthen it by punishing some countries that trade with Cuba. Nine U.S. presidents have upheld the Cuban embargo as the way to isolate Castro, but the U.S. is stubbornly playing solitaire. No other nation restricts trade with Cuba. In fact, in the past few years, hundreds of international companies have entered into joint ventures with Cuba, invited by Castro to fill an economic void left by the collapse of the Soviet Union and its substantial aid.

U.S. business leaders can only peer at the potential market through iron gates, and with Republicans in Congress as the gatekeepers, they may face quite a wait.

> **Sen. JESSE HELMS, (R), Chairman, Foreign Relations Committee**: Whether Mr. Castro leaves Cuba in a vertical position or a horizontal position doesn't matter to me. That's up to him, and that's up to the Cuban people. But he must— he will leave Cuba.

DEBORAH MARCHINI: *[voice-over]* Senator Jesse Helms heads the Foreign Relations Committee. He does not like Fidel Castro, nor does he like those who do business with Castro. Helms and Representative Dan Burton are sponsoring legislation to toughen the embargo. Their bills would ban imports to the U.S. of any product from any country made from Cuban raw materials, particularly sugar.

> **Rep. DAN BURTON (R-IN)**: We're saying that you're going to have to choose. Do you want to do business with Castro's communist dictatorship that represses their people and his people *[sic]*, or do you want to do business with the United States?

DEBORAH MARCHINI: *[voice-over]* President Clinton opposes the Helms-Burton effort. He says it unfairly punishes our trading partners and may violate GATT and the North American Free Trade Agreement. But Mr. Clinton does endorse the current embargo. It was tightened in 1992, barring international subsidiaries of U.S. companies from trading with Cuba, but easing humanitarian contacts, especially in telecommunications. Some prominent conservatives think the embargo should be lifted altogether.

> **WILLIAM F. BUCKLEY, Conservative Columnist**: With the disappearance of the cold war, it is simply one more hideous despotic country. I would happily preside over the execution of Fidel Castro, but I don't see that the cold war obliges us, as a— as an aftermath, to continue these policies towards Cuba.

DEBORAH MARCHINI: *[voice-over]* Many American business leaders agree. They're frustrated. Shut out of doing business in Cuba, they feel like they are the victims of the embargo.

> **KIRBY JONES, Executive Vice President, Burson-Marsteller**: It's hurting the farmers, it's hurting jobs in the U.S. This is an export market, and to that rice farmer in Louisiana or Texas, Cuba is a market for their rice.

DEBORAH MARCHINI: *[voice-over]* But even if the embargo were lifted tomorrow, Americans would find themselves at the end of a long line. Cuba already claims more than 200 joint ventures with non-U.S. companies. Italy's Benetton sells sportswear in eight stores, employing 65 Cubans. Mexico's Grupo Domos investing $1.5 billion for a 49% percent stake in Cuba's dilapidated phone system. Sherrit of Canada mines Cuban nickel, considered some of the purest in the world. The company is also the biggest independent oil producer on the island.

> **IAN DELANEY, CEO, Sherrit**: The change that we've seen in Cuba's approach to business and international commerce in the last four years has been amazing.

DEBORAH MARCHINI: What is less than amazing is the impact overseas capital is having on the Cuban people and their standard of living. The Castro government takes its share in hard currency, the workers, a much smaller share, and mostly in pesos. In a moment, where is America's Cuba policy headed, and will it arrive too late?

[Commercial break]

DEBORAH MARCHINI: Welcome back. We're talking about the U.S. trade embargo against Cuba. Joining me here in New York, Dwayne Andreas, chairman and chief executive officer of Archer Daniels Midland, one of the world's biggest producers of agricultural products. Also, John Kavulich, he is president of the U.S.-Cuba Trade and Economic Council, which compiles business information on Cuba for member businesses that hope one day to do business there. And joining us from our bureau in Miami, Representative Lincoln Diaz-Balart, Republican of Florida. Representative Diaz-Balart wrote much of the Burton bill seeking to toughen the embargo. He is also Cuban-born and the nephew of Fidel Castro.

Gentlemen, welcome, all of you, to Inside Business.

Dwayne, I'd like to start with you, if I can. What— give us one good reason why U.S. businesses should be allowed to do business with Cuba?

DWAYNE ANDREAS, Chairman and CEO, Archer Daniels Midland: Well, because all of our competitors,

from every country in the world, are already doing business in there. They're way ahead of us. Of course, it's inevitable that we will eventually open up business with Cuba, but when that happens, we'll be further and further behind.

DEBORAH MARCHINI: Right. Congressman, give us one good reason why U.S. businesses shouldn't be there along with everybody else?

Rep. LINCOLN DIAZ-BALART, (R-FL): Well, we should be there, but once the Cuban people are able to live in democracy and freedom. The reality of the matter is that good will, as Mr. Andreas, I'm sure, knows, as an extraordinary businessman, good will is difficult to build and easy to destroy, and the American business community has not been tarnished by association with the Cuban dictatorship. Right now, those who are investing in— in Cuba have replaced the Soviets as the hated symbols of the people who are collaborating with the dictatorship, and seen by the Cuban people as prolonging the regime. So it's— it's— it's difficult to create good will and very easy to destroy it, and what we would be doing is destroying the good will that the U.S. has by joining those who are now collaborating with Castro.

DEBORAH MARCHINI: John, you've done some research into Cuba. Is that the perception, from your view?

JOHN KAVULICH, President, U.S.-Cuba Trade and Economic Council: No. Most of the U.S. businesses that we talked to are interested in gathering information on Cuba, and under U.S. law, wherever they can engage Cuba today, they want to do so.

DEBORAH MARCHINI: Do the Cuban people like American businesses better because they're not there?

JOHN KAVULICH: I think—

Rep. LINCOLN DIAZ-BALART: Oh, there's no doubt about that. I mean, the fact is that they're not— they're not cooperating. The— they're not— American businesses are not collaborating with Castro, American business is not taking advantage of the slave labor and the $2 a month that Castro pays—

DEBORAH MARCHINI: Well, the question I'm asking John is from the perspective of the Cuban people, is this a matter of cooperating with Castro or providing them with jobs and dollars? John, what's your perspective? What is your perspective from the sense of the Cuban people, how they feel about the United States for not being there?

JOHN KAVULICH: Well, I think that the Cuban people look to the United States as the potential greatest market that they have for their exports. U.S. businesses look at Cuba as a tremendous export opportunity, as well. I don't think that the Cuban people generally look disfavorably *[sic]* upon the U.S. business community for not being there, but at the same time, they do want them there.

DEBORAH MARCHINI: Dwayne?

DWAYNE ANDREAS: Well, I know that it's the custom in the United States to demonize Castro, because that's the easiest way to talk about it for people who don't want to talk about the facts. The facts are that European companies and Central American companies are in there, and they're very welcome, and they're doing a lot of business, and they're very friendly. I am surprised mostly that our statesmen don't learn from history. After all, Nixon went to see Mao and opened up China, and China immediately began to open up, in a small way, market economy, and move toward democratic institutions. Reagan met with Gorbachev. Gorbachev told me just a few days later, "I'm going to have a market economy, I'm going to open all the churches again, and I'm going to have a free press." Now, Eisenhower said, "I'm going to go to Korea." Now, it proves that our statesmen have learned how to help reform communist countries, and why this beautiful little country of Cuba—

DEBORAH MARCHINI: You're saying the way to help reform communist countries—

DWAYNE ANDREAS: Is to be there.

DEBORAH MARCHINI: —to be there and do it through private enterprise.

DWAYNE ANDREAS: Absolutely. Be there and be associated in every conceivable way, and doing all the business you can possibly do.

DEBORAH MARCHINI: We have a statesman with us. Let's get his response to that.

Rep. LINCOLN DIAZ-BALART: One of the things that's— I agree it's important to learn from history. One of the things you learn from history is that each country has its own history and its own sociology and its own reality, and you cannot ignore the reality of Cuba. Cuba is a very nationalistic country, and Cuban nationalism is very real, and those people, like, for example, one of the companies that was featured, a Canadian company that was featured by this Moneyline segment that appeared during the week from Havana, Sherrit, this company not only is dealing in stolen property, it was property that used to belong to an American company, but its mining there the nickel from— from Oriente Province, taking it by ship to Canada. The waste, the disposal, the chemical waste, the poison that Canadian environmental law does not permit to be dumped on Canadian soil or water is then shipped back and Castro allows that it be dumped on Cuban soil and the water.

DEBORAH MARCHINI: All right, from your perspective—

Rep. LINCOLN DIAZ-BALART: So— so— do you think that that Canadian company has good will in the eyes of the Cuban people?

DEBORAH MARCHINI: Well, whether it's nice or not perhaps is not the point. Perhaps, what the point is, is whether an embargo is an effective way to change that or anything else. We've had more than three decades of an embargo against Cuba, and nothing has changed.

Rep. LINCOLN DIAZ-BALART: Well—

DEBORAH MARCHINI: What makes you think toughening the embargo would change anything?

DWAYNE ANDREAS: Look, our embargo has been a total failure for 30 years. My father taught me this.

Rep. LINCOLN DIAZ-BALART: Deborah, what we have—

DWAYNE ANDREAS: He said, "Son, when you're in a hole, stop digging."

DEBORAH MARCHINI: *[crosstalk]*

DWAYNE ANDREAS: I've also learned from the Chinese. The Chinese say, "If you don't change your direction, you'll wind up where you're headed." We're headed for a diplomatic Bay of Pigs. It's time for a change. We ought to have all the Americans in Cuba doing all the business they can.

Now, Clinton, to his everlasting credit, went to see Assad in Syria. He started the peace movement in the Middle East with that one meeting, to his everlasting credit. I'm sure that he's going to go and see— he's going to meet with Castro one of these days, and I'm sure if they have a common-sense conversation — and Clinton is a very common-sense man — he'll do like Eisenhower, like Nixon, like Reagan, he'll find a way for us to get along with our neighbor and be a good neighbor.

DEBORAH MARCHINI: I want to give the congressman a chance to answer to that argument. If 30 years of embargo have done nothing to bring down Fidel Castro or change communism, it's made the Cuban people poorer, why do you feel that toughening the embargo is the answer now?

Rep. LINCOLN DIAZ-BALART: What we had between 1962 and 1991 was an agreement between the Soviet Union and the United States that protected, in effect — and you know, that agreement came out of the missile crisis in October 1962 — that not only prevented the United States from invading, but prevented anybody from doing anything against Castro. The Soviet Union collapsed in 1991, thus the time became appropriate, after the collapse of the Soviet Union in 1991, to finally help the Cuban people get rid of that tyrant that we, for so many years, helped to protect because we had a deal with the Soviet Union that committed us to do so.

DEBORAH MARCHINI: But I put it to you that the Cuban economy has been collapsing for the last 30 years. What makes you—

Rep. LINCOLN DIAZ-BALART: It has been collapsing, but ever since the collapse of the Soviet Union is when we really have an opportunity, based on the fact that there's no shield from a superpower protecting that dictatorship, and much less is there a deal with the Soviet Union by the United States to protect them, so now is the time to help the Cuban people. We have to get along with our neighbor. They're 90 miles away. The Cuban people is our neighbor, not the tyrant to the Cuban people that denies the Cuban people human rights. And during this week, when I heard the absurdity by some so-called expert in this Moneyline program say that it was a class B— Castro was a class B human rights violator, during the time that Moneyline was there, more than 80 centers of worship, Protestant centers of worship alone in one province, were closed down, political prisoners were beaten in prison, at the same time that a handful were released for the press. The reality of the matter is that now is the time, after the collapse of the Soviet subsidies and our deal with the Soviet Union to keep Castro protected, to clamp down on the regime and help the Cuban people achieve freedom, and I'm really amazed that Mr. Andreas refuses to see the difference between China and Vietnam and Cuba.

DEBORAH MARCHINI: Are you saying Fidel Castro is a nice man—

Rep. LINCOLN DIAZ-BALART: Did you ever hear, Deborah, Deborah—

DEBORAH MARCHINI: —or are you saying something else?

Rep. LINCOLN DIAZ-BALART: —no, what I—

DWAYNE ANDREAS: I am saying— let me just tell you what I'm saying. Hubert Humphrey taught me long ago, if you have an enemy and you need to get rid of him, there is only one way to do it, and that's to make him into a friend, because any other way, he's still there somewhere. Now, my people, people that I know in other countries who are in there, tell me that if you get rid of Castro, you'll get something worse.

Rep. LINCOLN DIAZ-BALART: Well, that's absurd.

DWAYNE ANDREAS: Now, Castro has already opened the door for many, many reforms. We should be in there helping him to achieve these reforms.

DEBORAH MARCHINI: All right, we need to take a break on this point—

Rep. LINCOLN DIAZ-BALART: Dwayne, that's really incredible that you would say something like that. What the people have to have in Cuba—

DWAYNE ANDREAS: What I'm saying is credible, because—

Rep. LINCOLN DIAZ-BALART: —is an election, an election. Do you support an election in Cuba?

DEBORAH MARCHINI: Is this the way to get an election in Cuba?

Rep. LINCOLN DIAZ-BALART: Pressure—

DWAYNE ANDREAS: Are we getting an election the way we're doing it?

Rep. LINCOLN DIAZ-BALART: Did we get an— did we get—

DWAYNE ANDREAS: I think we would get an election within a few years if we were in there cooperating and working with him.

DEBORAH MARCHINI: All right. Gentlemen, I'm sorry.

Rep. LINCOLN DIAZ-BALART: Then what we have to do is do something like we did in Haiti.

DEBORAH MARCHINI: All right—

Rep. LINCOLN DIAZ-BALART: —that— which is also in this hemisphere. There we got a return to democracy.

DEBORAH MARCHINI: —I need to cut you off right here. We do need to stop for a commercial break. When we come back, what is the Cuban market worth to American businesses? Inside Business will continue in just a moment.

[Commercial break]

DEBORAH MARCHINI: Welcome back to Inside Business. We're talking about Cuba.

John Kavulich, as someone who's studied Cuba, what's this market really worth to American businesses?

JOHN KAVULICH: Well, it's worth enough that in 1994 more than 500 executives from U.S. businesses traveled to Cuba.

DEBORAH MARCHINI: Is that legal?

JOHN KAVULICH: Yes. They did so legally. It's worth

enough that U.S. businesses are continuing to register their trademarks and patents in Cuba. It's worth enough that they're continuing to do whatever they can do.

DEBORAH MARCHINI: Why? It's a small market, with poor people in it.

JOHN KAVULICH: Well, when you put a little context, and that is that the business community is coming to realize, rightly or wrongly, but they are coming to realize the fact that Fidel Castro is probably going to continue to preside over the commercial, economic and political transition within Cuba. Therefore, in order to say, "We're going to wait for him to depart the island," does probably not—does probably not make good business sense. So the companies, therefore, are saying, "All right, what's this worth to us now?"

DEBORAH MARCHINI: Dwayne, what's it worth to Archer Daniels Midland? Do you want to go in there to sell to the Cuban people, or to use Cuban labor?

DWAYNE ANDREAS: Well, I think Archer Daniels is just one of hundreds and hundreds of companies. It has no special interest to us, because we get along fine without Cuba. However, I do believe that we would sell very large quantities of vegetable oil there. We would sell proteins. I believe if the Cuban people could afford, they can sell enough things in the United States, they're very industrious, they're very well-educated, they're good workers. They could sell enough goods in the United States, they would take the money and they would buy beef and pork and chicken, and I think they would buy $4 or $5 billion worth of value-added food from the United States eventually.

DEBORAH MARCHINI: But do you think Cuba is more valuable to U.S. businesses as a market or as a source of labor?

DWAYNE ANDREAS: Well, I don't think— I think both. You can't have one without the other. They have to export to import.

DEBORAH MARCHINI: All right. Congressman—

DWAYNE ANDREAS: So one is equally important as the other.

DEBORAH MARCHINI: —Congressman, what's wrong with exporting some American jobs to Cuba and helping the people there?

Rep. LINCOLN DIAZ-BALART: I suggest that you read an article that recently was written by a Spanish investor who did take the advice of these two gentlemen that are with you today, a gentleman named Fernandez Gonzalez. He went in there, opened a business. One day, state security says, "Hand the keys over to your restaurant and you're on the plane tomorrow morning." He talked about what happened to him. There's no recourse, obviously, no rule of law, nowhere to complain except this magazine in Spain afterwards. And you know, what he says, though, the thing he most regretted, having invested and become a collaborator with Castro? The thing he most regretted, he says, is the hatred that he and the other businessmen inspired with the Cuban workers, and that's something that, again, you have to learn about Cuba. Did you ever hear somebody in the Chinese community, the Chinese-American community or the Vietnamese-American community speak, like I, who represent a majority Cuban-American community and am in constant touch with the Cuban people and— did you ever hear anybody in those communities speak like I speak about Cuba? Cuba's different, and let me tell you, if we don't realize that it's different, the good will that the U.S. has acquired over the years by not being the collaborator— a collaborator will be blown, and so I hope that we do learn from history and learn to differentiate and not think that this is China or this is Vietnam.

JOHN KAVULICH: Yes, Representative, it may be different, history may be different with respect to Cuba, however, when it comes to Cuba as an issue, with respect to U.S. policy, it is not the sole purview of a million or so people of Cuban descent in south Florida or New Jersey. It's the purview of 50 states.

Rep. LINCOLN DIAZ-BALART: That is discriminatory, what you've just said. Do you think that it's the sole purview of the Jewish-Americans, our policy with regard to Israel?

JOHN KAVULICH: No, nor the Czech-Americans, nor the Polish-Americans.

Rep. LINCOLN DIAZ-BALART: So let me say— but you don't hear— but you don't hear criticism of Jewish-Americans or black Americans because they're concerned about Israeli policies or South American policies.

JOHN KAVULICH: No one's criticizing you, Representative. What I'm saying is, it's not your sole purview.

Rep. LINCOLN DIAZ-BALART: It is not— of course, it's their sole purview.

JOHN KAVULICH: It's the purview of the national interest.

Rep. LINCOLN DIAZ-BALART: When we have the majority— when we have the majority in Congress, as I think we will, to pass Helms-Burton, is that the sole purview of the Cuban-American community? No, it's the American people. And let me say—

DEBORAH MARCHINI: Yes, Dwayne Andreas, I think, wants to respond to something you said.

DWAYNE ANDREAS: I live in Florida, and I have some information which, apparently, you do not, yet. Seven out of 10 Cubans that I know come to me and say, "There'll be dancing in the streets if the embargo ends, on the Cuban side and on the Miami side."

Rep. LINCOLN DIAZ-BALART: I agree with— now, I agree—

DWAYNE ANDREAS: I agree with the view of these, and I think very highly of the Cubans in Miami, they're wonderful people. I think, if they went back there and cooperated in the reforms that are going on in Cuba right now, tried to get some of their property bought back, tried to open new businesses, they would live to do a lot of good in the world, and they would be infinitely better off than they are just talking demagogueric *[sic]* words and trying to demonize Castro and everybody connected with him.

Rep. LINCOLN DIAZ-BALART: Dwayne, it's not an issue of demonizing, and I— and I really—

DWAYNE ANDREAS: It's demonizing.

Rep. LINCOLN DIAZ-BALART: —do you think that I'm speaking demagoguery? I'm sorry, because let me tell you, it's certainly not my intent, nor do I call you a demagogue. But let— but let me say this. It's necessary for the Cuban people to be allowed to be free, and to collaborate with Castro, it's not an issue of demonizing, who would be— the person who demonizes Castro is Castro. He's the one who sinks boatfuls *[sic]* of refugees and keeps political prisoners in prison for 20 or 30 years. That's— Castro does it, not people who demonize.

DEBORAH MARCHINI: All right. I'm afraid that we are out of time right here. Unfortunately, we have to end our discussion. I'd like to thank all of you, though, for coming to shed some light on this very controversial issue, which surely will not go away soon.

Dwayne Andreas, Archer Daniels Midland, thanks for being here. John Kavulich, of the U.S.-Cuba Trade and Economic Council, and Representative Lincoln Diaz-Balart, Republican of Florida.

And Inside Business will be back in just a moment.

[Commercial break]

DEBORAH MARCHINI: *[technical difficulty]*

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The preceding text has been professionally transcribed. However, although the text has been checked against an audio track, in order to meet rigid distribution and transmission deadlines, it has not yet been proofread against videotape.

Mr. SHAW. OK. Thank you. Mr. Chairman, I want to thank you for having this hearing today. I think that we've certainly got a lot of opinions, and I think that this hearing will put us in a better position.

Mr. REICH. May I add something, Mr. Shaw? I'd be happy to provide you a list of our members. It's public knowledge, it's a 501(c)(6) organization, it's tax exempt, and we're very proud to share the names of—in fact, I think it's important to do that, because Mr. Kavulich mentioned some companies that are members of our council, and I don't think that they would want to in any way be confused with another position.

So if you don't mind, I will send you a list——

Mr. SHAW. Mr. Chairman, I would ask unanimous consent that Mr. Reich's request could be honored.

Chairman CRANE. Without objection, so ordered.

[The following was subsequently received:]

U.S. – Cuba Business Council

MEMBER COMPANIES

Allen & Company

American International Group

Ameritech of Indiana

Amstar

Anheuser-Busch International

Bacardi Limited

Baker & McKenzie

Barnett Banks

Baxter International

Bristol-Myers Squibb

Brown-Forman

Chiquita Brands International

Chrysler

The Coca-Cola Company

Colgate Palmolive

Coopers & Lybrand

Diaz-Verson Capital Investments

Dow Chemical

Federal Express

First Union

Flo-Sun

Florida Power & Light

Ford Motor Company

General Motors

Goya Foods

IBEX Group

J.A. Flower Service

Kelley, Drye & Warren

Kelly Tractor

Miami Herald Publishing Company

J.P. Morgan

Owens-Illinois

Pepsi-Cola International

Price Waterhouse

Reynolds International

SmithKline Beecham

Texaco

Vincam Group

Mr. RANGEL. Mr. Chairman, would the Ambassador be kind enough to send it to each member, so that it would——

Chairman CRANE. Well, if it comes to the committee, we can replicate it and distribute it, so that that——

Mr. RANGEL. OK, that would be good. Thank you. I would want to see——

Mr. REICH. Oh, certainly, certainly.

Mr. RANGEL. And I'd like to join in in thanking you, Mr. Chairman, for having this hearing. It is clear that there's no one opinion about what's going on in Cuba and what we should do. And I hope you might consider going over there and finding out what the truth is, so that we can lead our great Nation down the path that allows Cuba to reach democracy as we know it.

Thank you, Mr. Chairman.

Chairman CRANE. Well, you are more than welcome. And I thank you guests for your participation and input today. And with that, the committee stands adjourned.

[Whereupon, at 1:59 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

WRITTEN STATEMENT

"A FIRST APPROXIMATION OF THE FOREIGN ASSISTANCE REQUIREMENTS OF DEMOCRATIC CUBA" [1]

by
José F. Alonso, Office of Research, Radio Martí Program, USIA, Washington D.C. 20547
and
Armando M. Lago, Ecosometrics International, 6321 Walhonding Road, Bethesda MD 20816

Submitted on behalf of the Association for the Study of the Cuban Economy (ASCE), Bethesda MD 20816

This short statement summarizes an analysis of development options for Cuba and distinguishes two main sectors: a modern foreign sector, which relies on investments from foreign corporations and from the Cuban exile community, and a local/domestic sector which comprises the current Cuban economy in a state of disrepair. In addition, three development options are analyzed: a partial privatization option similar to the current situation in Nicaragua, a second scenario assumes full privatization and admission of a democratic Cuba into the Caribbean Basin Initiative (CBI) five years after the onset of democratization, and finally, a third privatization scenario corresponding to full privatization and admission of Cuba into NAFTA fifteen years after the start of the transition period to democracy in Cuba. Projections were developed for three time periods, namely: five years after the onset of democracy (t+5), ten years (t+10), and fifteen years (t+15) after democratization[2].

Economic Model

The two sectors of the economy, foreign and domestic, were projected as follow using econometric methods. The local economy, currently in government hands, was projected using a Cobb-Douglas production function estimated with actual Cuban data. Variables used in the projection were net capital (net of depreciation) and labor. The effects of foreign investments on growth were also projected using capital-output ratios from the international development experience. In addition, the economic model traced gaps in savings and investments flows, and balance of payments gaps. Imports of food, intermediate inputs, machinery & equipment and oil products were projected using import elasticities estimated from Cuba's international commerce publications. A final sub-sector of the economic model estimates employment demand and labor force availabilities.

Sugar Exports

Until recently, sugar continued to be the most important product of Cuba. Sugar provided the largest share of employment and foreign exchange revenues. The sugar agricultural sector had received the benefit of mechanization and improved field practices. Meanwhile, the industrial sector lagged behind in technology although several mills were rebuilt and others replaced. For the sugar industrial to prosper in the future, to become competitive in the world market and to be the engine towards development, a substantial amount of investments must be made. These required investments will be needed a) to modernize and diversify, b) to obtain higher yields, c) to ameliorate ecological problems and d) to convert the industry into a modern industrial base. Eventually, the number of sugar mills (approximately 159 today) must be substantially reduced to lower costs and attain economies of scale if this industry is to become competitive again in the World market.

Today, for Cuba to compete in the sugar market, a substantial amount of refined or white sugar production is required and Cuba is essentially a raw sugar producer. Therefore, in order to reestablish its competitiveness and viability, the sugar industry must be redesigned. To achieve this task a carefully crafted plan must be implemented with the following goals in mind: convert to a white sugar industry, diversify the industry using sugarcane as raw material and reduce the large number of sugar mills, while concentrating production to attain economies of scales. These policies will allow the industry to become a leader towards diversification and growth. [3]

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[1]. No discussion, interpretation, results or comments contained herein can be attributed to the U.S. Government or any of its Agencies, including the U.S. Information Agency, Office of Cuban Broadcasting, Radio Martí Program.

[2]A larger and more thorough version of this summary statement is presented in: José F. Alonso and Armando M. Lago. "A First Approximation of the Foreign Assistance Requirements of a Democratic Cuba". Cuba in Transition. Papers and Proceedings of the 3rd. Annual Meeting of the Association for the Study of the Cuban Economy (ASCE). Vol. 3. Washington, D.C.: ASCE. November 1994. pp. 168 - 219.

[3]See our earlier research: José F. Alonso and Armando M. Lago. The Foreign Assistance Requirements of a Democratic Cuba: A First Approximation. La Sociedad Económica Discussion Paper No. 1. London: La Sociedad Económica. April 1994. pp. 1 - 61.

Two transition scenarios with partial and full privatization are discussed in this section. Under both scenarios, the U.S.A. market was projected because it is key and pivotal for the Cuba's economy. It is assumed that Cuba after fifteen years into the transition will be able to receive the benefits of lower or no trade barriers once full diplomatic relations with the United States and membership in NAFTA and CBI have been attained. Based on the above premise, this work assumed that by year t+15, Cuba could regain access to the U.S. sugar market with 1.5 million tons of sugar. It would become very desirable if no less than 0.5 million tons could enter the U.S. market once the trade barriers and other political impediments are dismantled in order to ameliorate the political and economic impact of the transition process towards democracy. Revenues were estimated utilizing the World Bank price projections and, depending on the scenario, the estimates range from $ 1.4 billion of 1992 dollars in period t+15 during partial privatization, to as high as $ 1.53 billion of 1992 dollars at t+15 under full privatization. There are no substantial differences in revenues under either scenario.

Ethanol is included as an example of a diversified sector which uses sugarcane as an input and its output is a by-product which can contribute ample foreign exchange earnings during the transition process. This industry has a ready market abroad if the U.S. is going to meet the mandatory fuel requirements of the Clean Air Act. Cuba could export up to 10.0 million gallons of ethanol as projected. The constraint facing the production of ethanol for exports will be the state of affairs of the installed capacity due to the lack of maintenance, and the upgrading required to bring the distilleries to modern standards. However, substantial investments will be required to meet the domestic demand and to increase to exporting capacity levels in the future. Other byproducts plants already installed will compete for investments, but they could contribute more by producing efficiently several domestic consumption products such as paper, yeast, etc. Using sugarcane as raw material for these plants is essential for the country given its comparative advantage in cane production. The elusive path of diversification is essential for Cuba if it is going to regain its competitiveness as a low cost sugar producer.

Non-Sugar Exports

Cuba's international tourism receipts had a 3.2% market share of the entire Caribbean region (excluding Mexico) in 1992, lagging behind important competitors, such as Puerto Rico, Bahamas, Dominican Republic, Jamaica, Bermuda, Barbados, and even the Caiman Islands. By year t+15, Cuba's market share of the Caribbean region's tourism receipts is expected to grow to 9% under the partial privatization scenario and to 11% under the full privatization scenario. Cuba's market share could grow to 15% of the Caribbean market if gambling would be allowed in Cuba. Deductions from tourism receipts must be made to reflect the high import content (i.e. as much as 64.5%) of the Cuban tourism industry. By year t+15, net receipts from tourism, were projected to be nearly $ 1.47 billion of 1992 dollars, as large (i.e. 97%) as the value of the Cuban sugar exports.

Nickel exports have been depressed since 1991 due to the plummeting of nickel prices in the World market. Current prices are less than the costs of producing nickel in Cuba. In addition, a large increase in world wide nickel capacity is projected by the World Bank for the near future. The projections assume exports of 55,000 tons by year t+15, well below the 100,000 tons projected by the Cuban government for year 2,000, but even our projections may be on the high side given the deplorable market conditions in nickel. Nickel exports were projected at $ 525 billion of 1992 dollars for year t+15 under the NAFTA scenario.

With the demise of the centrally planned economies in the USSR and Eastern Europe, Cuban citrus exports have collapsed to a shade of their 1989 peak value of $ 171 million dollars. The projections assume that citrus exports will recuperate and grow moderately to $ 266 - $ 292 million of 1992 dollars by year t+15. Exports of fisheries peaked at $ 149 million dollars in 1986 and have been declining ever since. Meanwhile, most of Cuba's catch --92% of its value-- comes from domestic waters, the Gulf of Mexico, the Caribbean and the North coast of Brazil. The projections assume abandonment of far away fisheries and concentration on nearby areas. The projections also assume a significant farm-raised fish and shrimp activity. Fishery exports were projected at healthy rates and may be as large as $ 195- $ 245 million of 1992 dollars in year t+15.

Fruits and vegetables were projected to grow rapidly to $ 331 million of 1992 dollars by year t+15 under CBI, and to $ 555 million of 1992 dollars under NAFTA. The largest export volumes will be achieved in green peppers, tomatoes, ornamental plants, melons and honey. These projections assumed that under the CBI, Cuba would become the second largest exporter (after Mexico) for a variety of products for which it has competitive advantage. Under NAFTA, Cuban exports of fruits and vegetables were projected to capture 10% to 30% of Mexico's share depending on the product.

Industrial exports were projected for 21 industrial products. These exports would rise to $ 1,064 million of 1992 dollars after 15 years into the transition under the CBI trade regime and to $ 1,736 million of 1992 dollars under NAFTA.

The major industrial export markets included biomedical products, textiles and clothing (Section 807), rum and orange juice concentrate.

Foreign Capital Flows and Remittances.
Projections of capital accounts of the Balance of Payments include remittances, foreign direct private investments, portfolio investments and foreign aid.

From their 1989 values of $ 173.4 million of 1992 dollars, remittances were projected to rise to $ 2,110 million of 1992 dollars for year t+15. These projections assumed an experience comparable to those of Mexico, El Salvador and the Dominican Republic; that is, of countries that have high rates of remittances per person residing in the United States. Private foreign direct investments were expected to rise from their current levels of $ 25- $ 50 million annually to $ 1,050 million of 1992 dollars annually by year t+15 under the CBI scenario and to $ 3,500 million of 1992 dollars annually under NAFTA, that is, comparable to the current rate for Singapore. Portfolio investments in Cuba's securities were projected to rise from nil to $ 400 million of 1992 dollars annually by year t+15 under CBI, and to $ 600 million of 1992 dollars annually under NAFTA; but given the current boom in portfolio investments in Mexico, and to a lesser extent in Chile, the projected portfolio investment rates may be underestimated.

Foreign aid flows were projected assuming rates per person comparable to Chile, Costa Rica, Uruguay and other countries that receive large amounts of foreign aid. US-AID funds were projected at $ 1,000 million of 1992 dollars annually during the first five years of the transition period. Loans and grants from the Inter-American Development Bank were projected as $ 200 million of 1992 dollars annually in year t+5, growing to $ 300 million of 1992 dollars annually by year t+15. World Bank loans and grants were projected to be $ 350 million of 1992 dollars annually by year t+5 under full privatization, growing to $ 500 million of 1992 dollars annually in year t+15. Cuba could qualify for balance of payment support loans of almost $ 200 million of 1992 dollars annually during a four year period from the International Monetary Fund. The total foreign assistance requirements of a democratic Cuba were estimated as $ 2.5 billion of 1992 dollars annually during the first five years of the transition.

Foreign Debt and Claims.
The foreign debt and claims on Cuba estimated included $ 6,500 million owed to the Paris Club and other European creditors, the 15,000 million of transferable rubles owed to Russia, the $ 1,800 million dollars of United States property confiscated without compensation in August 1960 and the $ 7,000 million dollars confiscated from Cuban citizens in 1960-61. This last figure was estimated via two different analytical research methods. One method relied on the capital-output ratios developed by Julián Alienes[4] of the Banco Nacional de Cuba; another method used capitalized (at 6% annual interest rates) net income streams from Cuba' 1958 gross domestic product. Both research methods coincided with the same estimate of losses. From a total value of confiscated property of $ 9,074 million dollars (which included US $ 1,570 million of capitalized urban housing and agricultural land rents) in 1960-61, estimates of the losses from property confiscated by Castro from Cuban citizens were developed by deducting from this total the confiscation claims from other countries: United States ($ 1,800 million dollars), Spain (US $ 350 million dollars), plus $ 100 million dollars for the claims of all the other countries which experienced confiscations without indemnization in Cuba. These other countries included: Switzerland (18 million swiss francs of claims settled on March 2, 1967) , France (10.8 miflion french francs of claims settled on March 16, 1967), Canada (claims settled on November 7, 1980), United Kingdom, Italy and Mexico.[5] In the Spanish case[6], an original claim of $ 350 million dollars was eventually settled for $ 40.0 million dollars on November 16, 1986.

In August 1993, the debt with the United States amounted to $ 5,364 million of current dollars and the value of claims by the previous and current citizens of Cuba were in the order of $ 20,430 millions of current dollars. The claim figures were estimated using 6% simple interest rates in accordance with international practices and conventions. No governments are indemnifying victims of human rights violations through payments in domestic currency.

Growth Projections and Implications for Claims-and Debt-Paying under Alternative Scenarios.
Output, employment, balance of payments and savings/investment projections were developed from the economic model using elasticities as pivot point projections methodology to take into account, albeit partially, the structural changes in the underlying economic system as it changes from Castro's command system to a free market economy. Because of

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[4]Julián Alienes-Urosa. Características Fundamentales de la Economía Cubana. La Habana, Cuba: Banco Nacional de Cuba. 1950.

[5]Michael W. Gordon. "THe Settlement Claims for Expropriated Foreign Private Property between Cuba and Foreign Nations other than the United States". 5 Lawyer of the Americas. 457. (1973)

[6]"Cuba to Compensate Spaniards for Property Seizures". Reuters. February 15, 1994

estimates were developed for damages from the extensive human rights abuses of the Castro government, damages which include loss of life and limb, time spent in prison, and suffering from tortures[7]. All throughout Eastern Europe, unresolved exchange rate valuation problems, the local domestic sector is projected in real 1992 pesos, while the dynamic foreign sector is projected in real 1992 dollars.

The rate of growth of output is projected using as proxy the rate of growth of employment at stationary real wages. Assuming that all claims and debts are paid, the projected annual rate of growth of output is 1.9% under partial privatization, 3.4% annually under full privatization/CBI scenario and 5.6% under NAFTA. Again assuming that all claims and debt are paid, employment is projected to grow at annual rates of 1.9% for the partial privatization scenario, 2.5% under the CBI and 4.1% under the full privatization/NAFTA scenario. Paying Cuban exile claims tends to reduce the rate of growth of both output and employment by 0.5% to 0.7% depending on the development scenario. However, Cuban exile claims could begin to be paid in the full privatization/CBI scenario after an eight-year grace period, and the current Cuban safety net could be maintained after judicious pruning and cuts in the Cuban health and social security system.[8]

The slow growth rate under the partial privatization scenario results in high levels of unemployment and its adoption as a development strategy would result in sacrificing an entire generation of Cubans before recuperating the 1985-89 income levels. The higher growth rates under NAFTA would reduce unemployment to negligible levels. In fact, labor force availability becomes a serious growth constraint in the latter years of NAFTA because of the slow growth rates of the Cuban labor supply in the next fifteen years.

A foreign exchange gap occurs during the first five years of the full privatization scenario, requiring foreign assistance of $ 2.5 billion of 1992 dollars annually during the early years of the transition. By year t+10 the foreign exchange gap is no longer a constraint factor. One way to insure that there will be no foreign exchange gap restraining the economic development is by officially devaluing the Cuban peso to a level, warranted by foreign exchange markets, where Cuba can qualify for grants and concessionaire loans payable in soft currency from the international development lending agencies.

The conclusions focus on the need for a fully privatized market economy for Cuba together with a foreign financial assistance package of $2.5 billion annually during the first years of the transition due to the country's inability to generate growth and employment during the early years. The fiscal and monetary authorities will have to operate on a very tight, conservative budgets (no deficits). The country sugar industry must undertake a diversification and modernization process to achieve the benefits of economies of scale. The diversification of the sugar industry could begin by utilizing byproduct plants in place which produce a range of products from ethanol, chemicals and electricity (via co-generation) for domestic markets. Cuba should join the CBI and NAFTA; otherwise it will not recuperate fast economically and its primary potential agricultural export products consisting of fruits and vegetables and other industrial products such as assembly operations, ethanol, rum, orange juice concentrate, and pharmaceutical products needed for growth and to diversify the economy will not materialize. The reality for Cuba is that it will need to utilize all its natural resources wisely and to implement well thought economic policies, otherwise its population will suffer through a very difficult transition period which could have serious lasting political consequences.

Discussion Paper is being retained in the Committee files*

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[7]Charles J. Brown and Armando M. Lago. The Politics of Psychiatry in Revolutionary Cuba. New Brunswick, New Jersey: Transaction Books, Rutgers University. 1991.

[8]José F. Alonso, Ricardo A. Donate-Armada and Armando M. Lago. " A First Approximation Design of the Social Safety Net of a Democratic Cuba". Cuba in Transition. Papers and Proceedings of the 4th Annual Meeting of the Association for the Study of the Cuban Economy (ASCE). Vol. 4. Washington D.C.: ASCE. 1995.

STATEMENT OF ERIC A. RODRIGUEZ
BRIDGE OF YOUNG CUBAN PROFESSIONALS

Chairman Crane and members of the Sub-Committee on Trade of the Committee on Ways and Means of the House of Representatives of the United States, good afternoon. My name is Eric A. Rodriguez. I am an attorney in Miami, Florida and a member of the Board of Directors of Puente de Jóvenes Profesionales Cubanos, Inc. (Bridge of Young Cuban Professionals) (hereafter "Puente"). I sincerely appreciate the opportunity to address you today on behalf of Puente regarding the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1995.

Let me tell you a little bit about our organization. Puente is an organization comprised of second generation Cuban-American professionals living in the United States. Our objectives are to hasten the collapse of the Castro totalitarian regime and participate in the establishment of democracy in Cuba, free of Castro's oppression and tyranny. To that end, our organization is active in communicating with dissident groups on the island, particularly young Cubans eager for freedom in their homeland. Puente has consistently spoken out against Castro's tyranny in print and the airwaves, including Radio Marti, and will continue to do so. Puente ultimately envisions the establishment of a democracy in Cuba that is invigorated by respect for: human rights, free expression, free enterprise, private property, and civil society governed by the rule of law.

Puente believes that the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1995 is a very effective vehicle for supporting the Cuban people in their struggle to bring an end to the totalitarian dictatorship, while facilitating a post-Castro transition to prosperity bolstered by the respect for democracy, human rights, free expression, free markets, and private property rights.

Puente does not accept the disinformation campaign emanating from Havana, which is echoed by some opponents of LIBERTAD here in the United States and abroad, that the Cuban people are overwhelmingly opposed to this promising legislation. All of our communications with Cubans, either inside the island or those who have recently arrived in the U.S. or elsewhere demonstrate that the opposite is in fact true. Indeed, on three separate occasions during the last few weeks, Puente has transmitted its radio programs on local Miami stations WCMQ and WQBA, respectively, during which opposition leaders inside of Cuba have been contacted by telephone (capitalizing on the new direct telecommunications links with the island) and put on the air to publicly and explicitly endorse (in great detail and at the risk of brutal repression) various specific provisions of LIBERTAD. These courageous individuals, each of which openly gave his actual name and organization, are: (i) Elizardo Sampedro Marín (President of the Partido Solidaridad Democrática in Havana); (ii) Adolfo Fernández Saínz (President of the Central Sindical Cristiano in Havana); and (iii) Aurelio Sánchez Salazar (President of the Partido Social Cristiano in Camagüey). Each of these organizations is part of a nationwide coalition of like minded opposition groups called the Unión Opositora Cubana, which is active throughout Cuba's fourteen new provinces.

The establishment of democracy, human rights, free expression, free markets and the restoration of respect for private property rights in Cuba must be preceded by the sweeping of the Castro brothers and their inner circle from power on the island. LIBERTAD, introduced by Senator Jesse Helms (Chairman of the Senate Foreign Relations Committee) and Rep. Dan Burton (Chairman of the House Western Hemisphere Affairs Sub-Committee) with extensive bipartisan support in both chambers of the U.S. Congress, includes various international embargo-tightening provisions and post-Castro assistance incentives designed to support the Cuban people in accelerating this desperately needed dramatic change.

In particular, Puente supports Section 202 of LIBERTAD as vital to Cuba's post-Castro economic recovery, with its provisions for financing, guarantees, assistance and favorable trade arrangements to be offered by the U.S. to a future democratically elected government in Cuba. This will be of great importance to the newly emerging post-Castro Cuban economy, which will be counted upon to lead Cuba out of its current economic deprivation and socialist mismanagement.

Puente also supports LIBERTAD because it would codify the internationally well-established legal proscription and sanctions against trafficking in stolen goods with knowledge of their illicit origin, thereby deterring foreign investment in Castro's Cuba by criminalizing this activity. Puente believes that the U.S. can seize the moral high ground by making clear that it will weigh in during the post-Castro property debate in Cuba in favor of the proposition that foreigners, who helped extend Castro's brutal reign with their investments, should have their properties auctioned off without any compensation. This would constitute an unmistakably powerful signal that will keep many foreign nationals from straying from the right side of history by investing in Cuba today. Accordingly, Puente believes Section 302 of LIBERTAD is vital because it establishes a new federal statutory cause-of-action whereby legitimate owners, whether they became U.S. citizens before or after Castro's confiscation of their properties back in Cuba, can seek to block these ongoing sales or leases of confiscated goods by seeking damages (after due notice, even treble damages) and attaching the U.S. assets of these purchasers in bad faith of such stolen property.

Puente also supports Section 301 of LIBERTAD which would deny entry visas into the United States to all executives of foreign companies (plus their employees, relatives and affiliates) which are benefitting from stolen property in Cuba, thereby creating an additional disincentive for foreign investment to prop up the faltering Castro regime. Those that indignantly moralize about the supposed extraterritoriality of LIBERTAD, simply misplace their focus. LIBERTAD does not purport to dictate to any foreign government or company what it should or should not do in Cuba. Rather, LIBERTAD seeks to hold these foreign entities accountable for the consequences of their opportunistic investments in Cuba, when they then seek to continue doing business within the national territory of the United States, where jurisdiction over these matters by the U.S. Congress and federal courts is incontrovertible. LIBERTAD will clarify the choices confronting foreigners, when they are deciding where to invest and transact business.

The U.S. should employ its unique prestige and influence intelligently in leading the rest of the world in a concerted effort to help the Cuban people liberate themselves from one of the last totalitarian remnants of the Cold War. Similarly, and without timidity about appearing heavy-handed internationally, America should utilize its considerable trade and aid leverage to justifiedly advocate for a sound foundation for Cuba's future by standing tall for democracy, human rights, free markets and constitutional liberties for all Cubans.

Puente is heartened that even the threat that LIBERTAD will become law is already having its intended effect. The Miami Herald reported on June 23, 1995, that "[f]oreign investments in Cuba are slowing because of concerns over [the Helms-Burton bill]." The Herald also reported that a Canadian firm and an Australian mining concern have called off plans to invest in Cuba, citing the imminence of the enactment of LIBERTAD as a principal reason. This turn of events is already proving that LIBERTAD will be an effective catalyst for positive change in Cuba. Therefore, Puente strongly urges this Sub-Committee and the full Congress to pass a strong version of LIBERTAD and set the wheels of Cuba's freedom in motion.

Statement of Representative Ronald V. Dellums
to the Committee on Ways and Means, Subcommittee on Trade
Regarding U.S.-Cuba Trade Relations, Post-Castro

June 29, 1995

Mr. Chairman:

I am honored to join my distinguished colleagues and expert witnesses to testify before the Committee on Ways and Means, Subcommittee on Trade.

It is with enthusiasm that I join my valued colleague, and brother, the Ranking Member, Mr. Rangel, as we once again visit the issue of U.S.-Cuba policy. I am honored to work with him in proposing a policy of sanity and reasonableness.

It is appropriate and useful at this time to address the need to normalize our relations with Cuba and to allow for the interchange of commerce, travel, telecommunication, postal, and other services between the United States and Cuba. I am pleased to cosponsor, with the Ranking Member, H.R. 833, and H.R. 1254 which have the major goal of lifting the embargo against Cuba. The other goals of the bills urge the President to take steps to negotiate with Cuba to settle U.S. nationals' property claims against Cuba as well as to reinforce internationally recognized standards of human rights.

I believe that our present policy against Cuba is wrong on several counts. The primary rationalization for our hostility against Cuba is that it a communist country. Yet we treat Cuba differently from the way that we treat other communist countries, especially large, powerful communist countries such as the Soviet Union before its collapse and present day China.

It is now a common mantra to say that the Cold War is over. China has become a major trading partner of the U.S. but both houses are considering reinforcing the economic strangulation of Cuba with even more vigor and vehemence.

Our present policy is wrong on ethical grounds. We are a nation which takes pride in being the greatest in military and economic might, and we also believe that we have an obligation to be fair and just. Our literature, our folk

ethos is that we are always for the underdog. Our present Cuban policy exposes this part of our national, historical sense of fairness to ridicule.

Our embargo is wrong on the basis of trade. U.S. businesses have recently expressed great interest in exporting, in trading with Cuba, as we do with Mexico and other countries in Latin America. They look to Cuba as our next lush market. Our embargo denies American businesses the opportunity to conduct business with Cubans.

Our embargo is wrong in terms of our relations with our allies, the European Union and Canada. The Burton bill would preempt their sovereign right to trade with another country.

Our embargo is wrong in terms of our ratification, our adoption of the Universal Declaration of Human Rights. Our present policy denies Cuban families of much needed foods and medicines; a policy akin to ancient, and primitive war strategy of encirclement which used starvation and disease to bring surrender.

Our embargo is wrong in terms of our citizens' right to move freely between non-combatant countries and to expand their cultural and geographical knowledge. It appears to be a policy which fosters, encourages ignorance. We are adopting, legislating a policy where we become dumb and dumber.

Our embargo is wrong because it intensifies our present, impoverished policy towards Cuba. One positive aspect of our present foreign policy, Cuba excepted, is that we are increasingly becoming advocates of a mediative approach to crises. The basis of our policy towards China, towards Russia, towards Saudi Arabia, is that violations of human rights, or alien philosophies and mores, are better treated through trade than through war. I would propose that we should extend this policy to Cuba. Thus, I am a proud cosponsor of H.R. 883 and H.R. 1254 and I encourage my colleagues to do the same. For those who advocate a change in Cuba's government and policy, clearly diplomacy, with its long and honorable history, is to be preferred over the use of blockade and bluster. I believe that we can achieve better results by using sugar, possibly even cane sugar, over bile.

RULES OF ORIGIN

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JULY 11, 1995

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RULES OF ORIGIN

TUESDAY, JULY 11, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 3:19 p.m., in room B–318, Rayburn House Office Building, Hon. Philip M. Crane (chairman of the subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
June 28, 1995
No. TR-13

CONTACT: (202) 225-1721

Crane Announces Hearing on Rules of Origin

Congressman Philip M. Crane (R-IL), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on rules of origin. **The hearing will take place on Tuesday, July 11, 1995, in room B-318 of the Rayburn House Office Building, beginning at 3:00 p.m.**

Oral testimony at this hearing will be heard from both invited and public witnesses. Also, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Countries use rules of origin to determine the origin of an imported good for the purposes of tariff assessment and application of other trade restrictions or requirements. Different rules are used to determine whether imports should be given particular preferences (for example, under a free trade agreement) or for non-preferential purposes (such as country-of-origin marking for consumer information). In recent years, questions have arisen regarding the effect of these rules on the free flow of trade, i.e., whether these rules are inconsistent, arbitrary, and non-transparent, creating significant trade and investment barriers.

In general, under U.S. law, goods are considered to be the product of a particular country if they are either wholly the growth, product, or manufacture of that country or if they have been "substantially transformed" there. The term "substantially transformed" is not statutorily defined, but rather has been the subject of administrative and judicial interpretation. On the other hand, preferential rules of origin to administer the North American Free Trade Agreement base "substantial transformation" on changes in tariff classification and the Treasury Department has proposed extending this approach to non-preferential rules. This lack of certainty and uniformity has lead to increased interest in the formulation of more transparent, predictable rules for determining the country of origin.

The Uruguay Round Agreement on Rules of Origin established a three-year work program to harmonize rules of origin among World Trade Organization (WTO) members on non-preferential trade. The new harmonized global rules of origin resulting from the work program could have a substantial impact on international trade patterns, on the conduct of U.S. importers and exporters, and on the international competitiveness of U.S. industries. On April 19, 1995, the International Trade Commission instituted an investigation and requested public comment on the work program.

In announcing the hearing, Chairman Crane stated: "Rules of origin play an instrumental role in determining who receives the benefits of our bilateral and multilateral trade agreements. I have several concerns about Treasury's administration of this rules of origin program. In addition, I want to ensure that the U.S. has a coherent position in the WTO discussions which reflects the interests of U.S. businesses."

FOCUS OF THE HEARING:

The focus of the hearing will be to review the administration of U.S. law for preferential and non-preferential rules of origin and the prospects for the WTO work program. The Subcommittee is also interested in hearing from the U.S. business community on the application of both preferential and non-preferential rules of origin.

WAYS AND MEANS COMMITTEE

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Wednesday, July 5, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Trade will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-6649.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Trade office, room 1104 Longworth House Office Building, no later than 1:00 p.m., Friday, July 7, 1995.** Failure to do so may result in the witness being denied the opportunity to testify in person.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Tuesday, July 25, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Trade office, room 1104 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available over the Internet at GOPHER.HOUSE.GOV, under 'HOUSE COMMITTEE INFORMATION'.

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Chairman CRANE. Today the Subcommittee on Trade will hear testimony on rules of origin from those government agencies responsible for developing and implementing the rules and those companies which must comply with the rules in order to remain competitive. Rules of origin play an instrumental role in determining who receives the benefits of our bilateral and multilateral trade agreements. Ideally, effective rules of origin are simple and transparent and ultimately serve as a stimulant to increased trade and investment. Companies demand and we must work to ensure that they have unlimited access to foreign markets to sell their products and source their products with as little administrative burden as possible.

In this vein, I support the administration's efforts toward global harmonization of rules of origin under the auspices of WTO, the World Trade Organization. We must work with our trading partners to develop universally accepted rules that do not disrupt the normal course of trade or impose significant compliance costs on U.S. industry. It is critical that U.S. industry play a supporting role in the WTO work program as they will ultimately be the ones to comply with these international new rules.

On the domestic side, I am concerned that the U.S. rules of origin recently proposed by Treasury may ultimately have an adverse effect on the wide range of industries, including hand tools, pharmaceuticals, electronics, coffee, food, and textiles. They are concerned that the proposed rules depart from the long-held principle of substantial transformation. These interim rules could also pose a significant administrative burden forcing industry to retool their operations twice, once to conform to the interim rules and again when the international rules are finalized.

I am interested in hearing from the administration witnesses on the wisdom of applying these new rules in advance of completion of the WTO work program. I strongly encourage the administration to work with industry to find a satisfactory solution to their concerns and an appropriate timetable which will, in turn, strengthen the U.S. position in the WTO.

I thank the witnesses for appearing today and look forward to their testimony. It is my understanding that the subcommittee has not yet received a written statement from Mr. Simpson. I must say that I am surprised that the administration would send a witness to testify without a statement. I expect Mr. Simpson's statement to be filed no later than Monday, July 17.

As we have a very full schedule today, please observe our 5-minute rule on delivering remarks, and anything beyond that will be made part of the permanent record. I would now like to recognize Mr. Payne. Do you have any opening comments, Mr. Payne?

Mr. PAYNE. No. Thank you for holding this hearing, and no comments. Thank you.

Chairman CRANE. Then we shall proceed starting with Mr. Simpson.

Mr. Lang, I deeply appreciate your being here today, too.

STATEMENT OF HON. JEFFREY M. LANG, DEPUTY U.S. TRADE REPRESENTATIVE, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Mr. LANG. Yes, sir, Mr. Chairman. I am glad to be here.

We have submitted a detailed statement, and I would like to summarize, if I can. My assignment today is to give you the status of the WTO negotiations you referred to.

As perhaps the subcommittee recalls, in the agreement itself we have some commitments on how rules of origin are administered, but not on the rules themselves; so that during this interim period, the rules would be administered according to standards of fairness and transparency, that sort of thing.

What we have in the agreement, however, is a commitment to undertake a new negotiation, which has just begun—we are really at the very beginning of it—in which we will try to deal with the question of harmonizing these rules of origin.

Obviously, this is a very technical exercise. The negotiating documents anticipate that the World Trade Organization will deal with the policy aspects of these negotiations—and there will be policy questions—and that they will be assisted by a technical committee under WCO, the World Customs Organization, what I used to think of as the Customs Cooperation Council.

This exercise is thought to take 3 years. We are just beginning. I fully support and the administration supports your encouragement to us to consult with industry, with the advisory committee system, and with the cognizant congressional committees on this exercise. So we are just beginning. It is going to be a long, difficult, technical process, and we are looking forward to working with you on it.

[The prepared statement follows:]

STATEMENT OF
JEFFREY M. LANG
DEPUTY U.S. TRADE REPRESENTATIVE

before

The COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE
JULY 11, 1995

I appreciate the opportunity to speak to the Members of the Committee on implementation of the Uruguay Round Agreements Act, specifically, the important work that we are embarking on to implement the Agreement on Rules of Origin and the negotiations to harmonize rules of origin.

With the proliferation of regional free-trade agreements and other preferential trade regimes, the issue of origin has become an increasingly important issue in international trade. Customs authorities around the world apply differing rules assigning an economic "origin" to traded goods in order to determine whether they should be given particular preferences (for example, under a free-trade arrangement) or for non-preferential purposes (such as country-of-origin marking for consumer information). In recent years, the application by many governments of origin rules in an inconsistent, arbitrary, and non-transparent manner has created significant trade and investment barriers, as has the lack uniformity in the rules applied by different countries. It was for this reason that the Administration, Congress and the private sector determined it necessary to address the issue by establishing a Committee on Rules of Origin in the WTO with a detailed work program to harmonize rules of origin.

The Agreement on Rules of Origin is intended to reduce those barriers by initiating a three-year work program that will lead to multilateral harmonization of origin rules, and by imposing disciplines that WTO members are obligated to observe during the process of negotiation. The Agreement should significantly improve the certainty and predictability that U.S. manufacturers face when conducting business internationally by removing the barriers that may result from origin rules. In our case, Congress has made clear that such an agreement will require new implementing legislation.

We are in the very early stages of discussions on the Work Program, and it has taken somewhat longer than we had anticipated to begin the very detailed work envisioned in the WTO and the World Customs Organization. USTR, in close cooperation with other Executive Branch agencies, particularly Treasury and Customs, and the U.S. International Trade Commission, is coordinating this important exercise.

Organization of the Negotiations

The Agreement establishes a WTO Committee on Rules of Origin, and

draws on the technical expertise of the World Customs Organization and a newly created Technical Committee on Rules of Origin. In the WTO Committee, negotiators will draw upon the work done by the WCO technical committee to develop rules that will be applied by all WTO Members to all non-preferential trade.

The Technical Committee will be responsible for such matters as examining specific technical problems and providing recommendations on appropriate solutions, furnishing advice to WTO members or the Rules Committee on origin questions, preparing periodic reports on the operation of the Agreement, and reviewing annually technical questions concerning the implementation of Parts II and III. The United States participates actively in both the WCO and WTO Committees.

The Agreement also sets out the disciplines that the WTO Members shall observe during the interim period and that shall be reflected in the harmonized rules. The most important elements include:

-- rules of origin applied to imports and exports shall not be more stringent than rules used to determine whether or not a good is domestic;

-- rules of origin shall not discriminate between other Members;

-- rules of origin shall be administered in a consistent, uniform, and reasonable manner;

-- changes in rules of origin, or new rules, may not be applied retroactively; and

-- rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade, nor shall they impose conditions not related to manufacturing or processing.

In order to assist us in pursuing this work program, Ambassador Kantor requested the United States International Trade Commission to undertake an investigation, pursuant to Section 332 (g) of the Tariff Act of 1930. In making this request, Ambassador Kantor emphasized the importance of ensuring that U.S. private sector interests are taken into consideration. He further requested that the Commission solicit public comments on the proposed rules of origin, and, if requested by interested parties, that the Commission consider holding public hearings on the matter.

In addition to developing initial proposals for submission to the WCO Technical Committee, the USITC will assist the Administration in a technical review of any proposed rules. Finally, Ambassador Kantor requested assistance in making information available to the staffs of the House Ways and Means Committee and the Senate Finance Committee on a regular basis. The USITC's work program, initiated in response to Ambassador Kantor's request, will follow the rhythm of the negotiations. At each stage of the work program, the USITC will solicit public comment through publication in the Federal Register. Mr. Rosengarden from the

ITC is available to address any questions you might have with respect to the Commission's work.

SUMMARY OF THE AGREEMENT AND THE WORK PROGRAM

The Agreement consists of four parts and two annexes. Part I describes the Agreement's scope of coverage. Part II establishes disciplines on the "non-preferential" rules of origin that WTO members should follow during the course of negotiation. Part III sets out procedures for review, consultation, and dispute settlement. Finally, Part IV establishes the three-year work program leading to harmonization of rules of origin. Annex I to the Rules Agreement describes the role in the work program of a "Technical Committee on Rules of Origin" to be established under the auspices of the World Customs Organization formerly known as the Customs Cooperation Council (CCC). Annex II sets out disciplines governing "preferential" rules of origin.

The three-year work program is designed to harmonize the non-preferential rules of origin applied by WTO members. Article 9 of the Agreement establishes fundamental principles and objectives for the harmonized rules, including objectivity, predictability, and coherence.

The technical work will be conducted by the Technical Committee on a product-sector basis using the Harmonized System nomenclature) under the direction of the WTO Committee. As provided for in Article 9 of the Agreement, the basic principle under which the Committees will conduct their work is that a product will be considered to originate in the country in which it was "wholly obtained" or, if the product is produced in more than one country, in the country where it was last substantially transformed.

The Technical Committee will first develop proposals regarding when goods are to be considered as "wholly obtained in one country;" and those minimal operations or processes that do not by themselves confer origin on a good. These proposals are to be submitted to the WTO Committee for consideration and action within three months of its initiating a formal request.

Article 9 of the Agreement establishes a preference for the use of "change in tariff classification" as the sole criterion for determining whether a substantial transformation has occurred. This reflects a consensus in the international trading community that such a test provides much more certainty and transparency than other criteria. The Technical Committee will be asked to develop proposals on how the change of tariff classification test should apply to particular product categories. The Technical Committee will submit its final proposals on this subject within fifteen months after it is requested to begin work in this area.

Finally, the Technical Committee will be asked to consider those product categories for which a change in tariff classification alone does not adequately reflect a substantial transformation. The Technical Committee will provide the WTO Committee proposals on the use of criteria -- including *ad valorem* percentages or manufacturing or processing operations -- when necessary to

supplement the change in tariff classification criterion as the basis for conferring origin for such products. The Agreement requires the Technical Committee to submit its final proposals on this subject within 25 months after the Rules Committee requests it to begin work in this area.

The WTO Committee will review all of the work of the WCO, and, as appropriate, make the necessary changes to assure a coherent and balanced agreement that can be accepted by the WTO members. In the intervening period the WTO Committee will provide the policy guidance needed for the WCO to complete its work.

All proposals will be reviewed by the WTO Committee. Once the Rules Committee has completed its consideration, the harmonization agreement will be forwarded to the WTO Ministerial Conference for action and approval.

Work Thus Far

There have been two meetings of the WTO Committee which have concentrated primarily on administrative and procedural issues. Similarly, the WCO Committee is still getting organized, including dealing with the additional administrative burden of assuring that its work is provided to the WTO in all WTO languages, including Spanish.

At the next WCO Technical Meeting, to be held in early Fall, the Technical Committee will address the definitions for "wholly obtained goods" and "minimal processes that do not confer origin." After this meeting, the results of this work will be submitted to the WTO Committee.

I have mentioned the interagency cooperation in this effort and the ITC's provision for public comment. Additionally, the Congressionally-mandated private sector advisory committee, the Industry Functional Advisory Committee (IFAC) on Customs Matters is actively engaged in the development of policy positions for negotiations.

We are at the beginning of a very detailed and technical exercise that will require full consultation with the Committee and the private sector as the negotiations proceed. I look forward to working with you on this complicated but critical issue in the months ahead.

Chairman CRANE. Thank you very much.
Mr. Simpson now.

STATEMENT OF JOHN P. SIMPSON, DEPUTY ASSISTANT SECRETARY, REGULATORY TARIFF AND TRADE ENFORCEMENT, DEPARTMENT OF THE TREASURY

Mr. SIMPSON. Thank you, Mr. Chairman.

We have rules of origin for one reason only: not to torment the business community, but to attempt to give effect to laws enacted by Congress that treat goods differently based on their country of origin. Sometimes that different treatment is preferential, and Congress has repeatedly made it clear that it wants those preferences limited to the intended beneficiaries and not exploited by unintended parties. In other cases, that different treatment is punitive or restrictive, and, again, Congress has repeatedly made it clear that it wants those penalties or restrictions not to be easily circumvented by the intended targets.

We attempt to administer these laws according to the intent of Congress as it was expressed at the time the laws were enacted. Although Congress has frequently enacted laws that treat goods differently based on their country of origin, it has never prescribed specific rules for determining origin. As a consequence, the Customs Service has made origin decisions on a case-by-case basis, attempting to apply principles distilled from decisions of our courts over the last century.

I think I can guarantee you that the one thing on which everyone who will appear before you today will agree is that this process of making origin decisions on a case-by-case basis has been notoriously nontransparent, inconsistent, and unpredictable.

Beginning a few years ago with the U.S.-Canada Free Trade Agreement, and then with the North American Free Trade Agreement, and most recently with the proposed rules we published in January of last year for application to all goods entering the United States, we have tried to bring some clarity, transparency, and predictability to this process.

The suggestion has been made that we should have postponed publishing these rules. Let me tell you why I think that is not a good idea.

First, withholding publication of these rules does not change the substance of the decisions that the Customs Service makes. It simply prevents the business community from knowing in advance what those decisions are going to be. In other words, it leaves them in the dark.

The rules that will be agreed to by the WTO will not take effect for at least 5 years, and perhaps longer. I think that the large majority of industries—most of whom are not here today—who support these rules should not be denied the benefits of published transparent rules until well into the next century.

Let me point out also that experience has taught us that when we enter into international trade negotiations to harmonize trade rules, we are at an acute disadvantage if we have no operating model of our own to compete with the European model. When we entered into negotiations to harmonize value rules better than a decade ago, a decade-and-a-half ago now, we found that the Euro-

pean Brussels Definition of Value was up and operating, it was the accepted model, and, therefore, the GATT valuation code looks like the Brussels Definition of Value.

The same thing happened with the harmonized system nomenclature. It looks very much like the European nomenclature because they had a superior system up and in operation. I am convinced, if no one else is, that if we go to these negotiations in Brussels with no operating model of our own, the tendency of this group is going to be to gravitate toward the European position, which is up and operating and in effect.

Beyond that, Mr. Chairman, I think this is the most important thing I can say today: The problems you are going to hear about will not be abated no matter how cleverly we devise rules of origin. The problems lie in the laws themselves, the laws we are trying to administer. Most of these laws were designed and implemented by Congress at a time when the world economy was very different, at a time when, for example, an article made in Germany would have been entirely manufactured in Germany with parts that were produced in Germany. In today's world, that same article might be produced in stages in two or more countries using parts that have been sourced all over the world.

We are trying to apply laws developed in the late 19th and early 20th century to the economy that is emerging in the 21st century. There are two ways we can cope with this. One is to exempt certain industries from laws that have very restrictive or inconvenient effects. In fact, a little over 1 year ago, I met with members of the coffee industry and recommended to them that they seek an exemption from the country of origin marking, and I believe they have legislation to do that before you today. I recommend that you give it serious consideration.

Another option is simply to define an alternate standard to the substantial transformation standard that we have used historically to define the process by which origin is converted from one country to another. If Congress wants, it can prescribe another standard, a minimal transformation standard, or a last-place-of-assembly standard. We would have no objection to that. But I would point out to you that if you do that, laws you enact that impose quotas or economic sanctions or benefits may not have the effects that you intend.

Thank you.

[The prepared statement follows:]

STATEMENT OF JOHN P. SIMPSON
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR REGULATORY, TARIFF AND TRADE ENFORCEMENT
BEFORE THE
WAYS AND MEANS SUBCOMMITTEE ON TRADE

JULY 11, 1995

Rules of origin are used by the U.S. Customs Service to assign a nationality to goods moving in international commerce. This allows Customs to give effect to laws enacted by Congress that treat goods differently according to their national origin.

The treatment accorded by these laws may be preferential, as is the case with the Generalized System of Preferences (GSP), the Caribbean Basin Economic Recovery Act (or Caribbean Basin Initiative (CBI)), the U.S.-Israel Free Trade Agreement, and the North American Free Trade Agreement (NAFTA). Or it may be punitive, as is the case with the Trading With the Enemy Act, the International Emergency Economic Powers Act, the (repealed) Comprehensive Anti-Apartheid Act, and retaliatory actions taken by USTR under authority granted by Congress. Or it may be simply restrictive in some sense, as is the case with textile and agricultural quotas and, arguably, the country of origin marking law.

In enacting each of these laws, Congress has always made clear its intent that in carrying out the law meaningful distinctions should be made. Preferential treatment should be limited to the intended beneficiaries and not exploited by others; punitive or restrictive treatment should not be easily circumvented or evaded by the intended targets.

Although Congress has enacted numerous laws that require country of origin determinations to be made, Congress has not prescribed specific rules for determining country of origin. In order to give effect to the intent of Congress, U.S. courts have applied the standard of "substantial transformation" to describe the circumstances under which the origin of a good is transferred from one country to another. Requiring that a good be substantially transformed in order to acquire a new country of origin ensures that the intent of Congress in making country of origin distinctions will be carried out.

Unfortunately, precedential rulings by Customs and U.S. courts are highly fact specific. Therefore, the decision in a particular case is applicable only to the specific facts of that case and provides little guidance for other situations. Moreover, neither the courts nor Customs in its attempt to follow court rulings has successfully articulated a consistent rationale for determining when substantial transformation has occurred.

As a consequence, commercial parties have had no guidance for determining the treatment to which their goods are subject under U.S. law. Although Customs provides advisory rulings, there are limitations on the number of rulings Customs can issue and on the ability of Customs to provide rulings with sufficient timeliness.

Despite repeated complaints from the trade community about the unpredictability of decisions on origin, and frequent litigation, it was not until the United States and Canada began negotiation of the U.S.-Canada Free Trade Agreement that a serious effort was made to develop a systematic way to determine the origin of goods. The Government of Canada made clear that it would not agree to a free trade agreement in which the eligibility of goods for preferential treatment was determined by U.S. Customs on a case-by-case basis (as is the case with the U.S.-Israel Free Trade Agreement, GSP, and CBI).

In response to Canadian insistence, U.S. negotiators began development of product-specific rules for identifying goods eligible for preferential treatment. Goods that did not wholly originate in either Canada and/or the United States could nonetheless become eligible for preference by being processed in one or both or the parties so as to undergo a specified change in tariff classification. In addition, some goods were required to satisfy a regional value-content requirement. Despite widespread skepticism on the part of U.S. industry over whether tariff shift rules could take the place of case-by-case decision making, the final agreement provided for eligibility for preference to be determined primarily on a tariff shift basis.

Although the regional value-content requirement proved to be extremely troublesome (and was the subject of much attention during the NAFTA negotiations) the rules based on change in tariff classification succeeded in providing a transparent, predictable, and easy-to-administer system for identifying goods eligible for preferential treatment.

Because of the success of the tariff shift rules in the U.S.-Canada Free Trade Agreement, Customs began to explore with various industry groups the use of the tariff shift approach for rules of origin for non-preferential purposes, such as country of origin marking and quota administration. Although this effort was begun shortly after the U.S.-Canada Free Trade Agreement took effect, it was not until NAFTA negotiations began that significant progress began to be made. Because of the interest of U.S. industry in the NAFTA rules for defining goods eligible for preferential treatment, a large group of industry advisors became knowledgeable about the tariff shift concept and how it could be used to create rules of origin. Customs took advantage of this resource to accelerate work on non-preferential rules. Additional impetus was given by the insistence of both the Canadian and Mexican Governments that the U.S. publish the rules of origin that it would use to administer the U.S. country of origin marking law. By the end of 1993, a complete proposal had been developed, which was published in the Federal Register on January 3, 1994 for public comment.

In developing the proposed rules, Customs set as one of its chief objectives a condition that, to the extent feasible, the new proposed rules would avoid substantive change by reflecting origin rulings previously issued by Customs and by U.S. courts. Because of the absence of consistency in issuing rulings in the past it was not possible to maintain all previous rulings; that is, in many cases rulings conflicted with each other. And in a few cases, previous court rulings were based on a rationale that had been discredited in subsequent court decisions. Nonetheless, the rules published for public comment tracked previous practice to the extent possible, and Customs has used comments received in response to the Federal Register notice to identify rules that inadvertently deviated from past practice.

Should Publication of U.S. Rules Be Postponed?

Some groups have suggested that the U.S. should postpone publication of origin rules until after completion of the international rules of origin harmonization program being undertaken by the World Trade Organization (WTO). These groups argue that otherwise they will be required to change origin rules twice, once to conform to the rules published by Customs and then "three years later" to conform to the WTO rules. There are reasons why postponement is undesirable.

(1) The rules of origin being developed within the WTO harmonization effort are unlikely to take effect in less than five years. The timetable set by the Uruguay Round agreement calls for the World Customs Organization (WCO) to complete development of rules of origin based on the tariff shift concept within three years. The WCO product, along with any issues not resolved by the technicians working in the WCO, will be referred to the WTO at the end of that three year period.

The WTO will then need time - at least one year - to resolve thorny issues that could not be resolved within the WCO and to adopt the final product. The finished agreement must then be ratified by Congress. Allowing one session of Congress for ratification, and assuming that Congress will make the rules effective at the beginning of the following year, the rules could be in effect at the end of the fifth year. The effective date could be further delayed if Congress allows additional time for affected industries to adjust to changes. For example, Congress deferred for two years the effective date of changes to origin rules for textiles and apparel that it made in the Uruguay Round implementing legislation.

This timetable makes some perhaps optimistic assumptions about the speed with which the WTO and Congress will be able to act.

Moreover, it may be in the interest of the United States and other major trading countries to allow the WCO additional time to develop tariff shift rules, rather than hold rigidly to the three-year time limit. In any case, the rules developed through the WTO process will at the earliest not be in effect until some time in the next century. It would be unfair to deny the benefits of transparency and predictability that published rules provide to the great majority of businesses that support them.

(2) The U.S. will be at an acute disadvantage if it enters into any negotiations for harmonizing trade rules without a functioning system of rules that it can offer as a model. Experience in other similar harmonization efforts has shown that the representatives of other countries involved in negotiations are typically cautious and have a tendency to gravitate toward the proposals of countries - historically those of the European Union - that have well-developed and tested systems in effect. If U.S. representatives arrive at the negotiating table with thoughtful but untried proposals they will have great difficulty in attracting support.

<u>If Customs publishes rules now won't U.S. companies have to adapt to new rules twice?</u>

As noted, Customs has made a conscientious effort to preserve the current practice (with the exception of rules for textiles and apparel which were changed by Congress in the Uruguay Round implementing bill). Few companies who have asked for rulings from Customs will find those rulings altered by the new rules, although some rulings previously issued by Customs with respect to hand tools have been affected by decisions recently issued by the courts, and rulings issued to textile and apparel producers have been changed by act of Congress.

The complaint about "two changes" arises chiefly because, in the absence of published rules or specific rulings, companies have had the latitude to make their own origin determinations that are most convenient for the companies' existing operations. These decisions are not necessarily those that Customs, in order to give effect to laws enacted by Congress, would have issued to these companies had they requested rulings.

For example, it is becoming apparent that companies involved in multinational manufacturing and materials sourcing may have developed their own origin rules to assure that origin is conferred in the last country in which processing occurs. This enables them to minimize the need to identify the sources of materials and components and, if the last country in which processing occurs is the United States, it enables them as well to avoid the burdensome requirements of the U.S. country of origin marking law.

Although the publication of rules by Customs will curtail the latitude that companies have had to create their own origin rules, it does not represent a change of practice by Customs. From that point of view, any changes made as a result of the WTO harmonization program will be the first change, not the second.

Withholding publication of rules will not effect the substance of Customs' decisions on country of origin.

The origin rules proposed by Customs reflect the views of Customs as to what constitutes a substantial transformation. Should Customs be prevented from publishing rules, and be forced to deal with origin questions through case-by-case rulings, the substance of those rulings will be the same, since the purpose of the proposed rules is to codify positions that Customs has taken or would take on a case-by-case basis. Indeed, in order to assure consistency of origin determinations at all ports of entry, and in order to assure that origin determinations made for non-NAFTA goods are consistent with those made for goods exported from NAFTA countries, Customs would be required to use the proposed rules as internal guidelines.

Although the substance of Customs' position as to origin determinations will not be altered if the rules are not published, the transparency that is provided by published rules will be lost. Moreover, while Customs must seek public comment through the Federal Register for rules established by regulation, there is no provision for doing this with respect to internal guidelines.

Finally, rules of origin exist only because Congress has enacted laws that treat goods differently according to their origin. These laws can subject businesses to penalties and restrictions, and they require businesses to maintain information on the origin or goods and materials that would not otherwise be kept. But those are the natural and intended consequences of the laws. It is shortsighted to blame rules of origin for giving effect to the intent of the lawmakers

Rules of origin in themselves are problematic only if they are administered so as to produce results that are inconsistent and unpredictable. The history of administration of rules of origin in the United States is that inconsistency and unpredictability occur when origin rules are not made public and when they can be changed by the administering authority without public comment.

Publishing origin rules as regulations assures that origin decisions will be made according to a transparent system, and that future changes can only be made following a period of public comment. That is all that an administrative agency can do. The difficulties for businesses that result from the natures of the laws themselves can only be addressed by the Congress.

Chairman CRANE. Thank you, Mr. Simpson.
Mr. Banks.

STATEMENT OF SAMUEL H. BANKS, ASSISTANT COMMISSIONER, OFFICE OF FIELD OPERATIONS, U.S. CUSTOMS SERVICE

Mr. BANKS. Thank you, Mr. Chairman.

As stated, Customs is charged with administering the rules of origin, and as Mr. Simpson said, we do base it on substantial transformation. Today the situation we are faced with is dealing with a case-by-case determination, depending on the facts of each individual case.

Although we have got a lot of precedent out there and we try to diligently follow the court decisions that are out there, the situation remains that there is not a lot of predictability in this process for the industry.

When NAFTA came into place, we did try to create NAFTA marking rules which are based on a tariff shift principle, the idea that it would be much easier by going from one tariff classification and moving to another during the manufacturing process. It would be simpler for industry to understand when a shift of a country of origin determination is made.

In trying to develop these NAFTA rules of origin, what we tried to do is track these tariff shift rules as closely as possible to how we make our determinations today under substantial transformation; thereby, we are really trying to replicate a lot of the decisions that are out there today so that there are not a lot of changes, so that there is not a lot of disruption with industry.

I guess in support of this process we have had these rules in place since January 1994, and they seem to be working better. They seem to provide more transparency and more predictability in the process. So that is the situation we are into in this interim period, trying to live under the constraints of law, and the law that we have to follow is substantial transformation; but we are trying to provide a methodology under these tariff shift rules to give more predictability and more transparency to industry. That is the objective we are under at this point.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF
SAMUEL H. BANKS
ASSISTANT COMMISSIONER
U.S. CUSTOMS SERVICE

before

THE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE
JULY 11, 1995

Good Afternoon. I am Sam Banks, Assistant Commissioner of Customs, Office of Field Operations. Thank you, Mr. Chairman, for the opportunity to appear before you and this committee this afternoon on behalf of the Customs Service and on this subject.

As you know, the Customs Service is responsible for administering the tariffs, quotas, country of origin marking requirements, enforcement of sanctions, etc., in connection with all articles imported into the United States. In order to be able to administer and enforce these and many other laws, Customs must determine the country of origin of the article at issue. Country of origin is determined on the basis of one of two possible circumstances:

(1) The country of origin can be the country in which a good is "wholly produced or manufactured". Or

(2) If the good is not wholly produced or manufactured in a single country, the country of origin of the good is the country in which the materials contained in the good last underwent a "substantial transformation."

In today's environment of global economies and internationally integrated corporations, very few manufactured articles are wholly produced in a single country. So, most country of origin determinations are made on the basis of the latter criterion, i.e., the country of last "substantial transformation". An article is considered to be "substantially transformed" when as a result of a process or manufacture, it becomes a new and different article of commerce, having a new name, character, and/or use.[1]

Customs employs the same substantial transformation standard

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[1]The use of the term, "and/or" refers to the fact that the Court of International Trade originally stated the standard as "new name, character, and use" in United States v. Gibson-Thomsen Co., 27 CCPA 267 (1940). In recent cases, the court has described the standard as requiring a new name, character, or use, but then most cases, it has dismissed "name" and "use" as being significant factors and decided the substantial transformation issue on the question of change in "character".

for all country of origin determinations, i.e., regardless of whether the country of origin is needed for duty rate, quota, or marking. Nevertheless, the Customs Service has endeavored to apply the standard on a totally objective basis, without consideration of the competing industry interest groups. Consultation with industry may be required for the purpose of obtaining technical data regarding the operations under consideration and features of the article before and after the operations, but the final decision by the Customs Service is made on a purely objective basis.

As a result of this approach, the Customs Service has learned that there are always two sides to the issue in country of origin determinations. Generally, if we find that an article has been substantially transformed into a new and different article of commerce, the importers of that article may or may not be happy with this result. In some cases, the importer may want the article to maintain its original country of origin because of higher duty rates or quota restraints imposed on products from the second country. Of course if the duty or quota benefits exist in the country where the processor exists, he will want the articles to be considered substantially transformed by the processing performed in his country.

Similar contrasts can be drawn between the interests of the domestic industries versus importers with respect to the same articles that are the subject of a Customs determination of substantial transformation. A domestic producer of a product--let's take golf club shafts-- may not want Customs to find that the assembly of imported shafts with domestic golf heads and grips result in a substantial transformation of the imported shafts in the U.S. The domestic producer wants the golf club marked as to the foreign origin of the shaft. The importer of course, who also may be a domestic producer of some of the parts, does not want to have to mark the finished golf clubs. Yet, neither the domestic producer nor the importer in this case will be concerned if Customs finds the same processing in France involving British golf shafts results in substantial transformation into a French golf club.

These are just a few examples of why it is not in the interest of the government and sound administration of the Customs laws for the Customs Service to be drawn into various wishes of industry sectors when making substantial transformation determinations on the basis of specific known facts.

Yet, under the present system, with the exception of goods from NAFTA countries, Customs determination as to whether there is or is not a substantial transformation is made on a case-by-case basis. These determinations are made by Customs at the time of liquidation of the entry or prior to importation in binding rulings requested in advance.

As you also may know, Customs is applying tariff shift rules, known as the "Marking Rules", for determining the country of origin of goods imported from NAFTA countries. These rules were purposely developed by Customs to track and codify our current practice of administration of the substantial transformation principle. The NAFTA Marking rules have been in effect and in use since January 3, 1994, and I can report that they have worked very well in providing

transparency, predictability and objectivity in country of origin determinations for the purposes now being served.

Since, as I stated, the NAFTA Marking rules codify and express the same substantial transformation principle that is applied by Customs and the courts to all country of origin determinations, Customs has proposed to adopt these rules for all Customs purposes. The first practical benefit from using these rules is to keep companies that make the same goods in both NAFTA and NON-NAFTA countries from having to apply two types of rules for determining origin of goods imported into the U.S. But I think the most important reason for Customs to adopt these rules for all Customs purposes is so that predictability and transparency can be provided in country of origin determinations, which in turn, helps Customs to fulfill its obligations under the "shared responsibility" concept of the Mod Act [Title VI of the NAFTA Implementation Act]. As you know, we made an agreement with the trade that they are to exercise "reasonable care" to comply with the Customs laws, but we are to ensure that all compliance requirements are clearly spelled out as part of our obligation under the concept of "informed compliance". Compliance with Customs requirements necessarily includes country of origin designations relating to marking, duty-rates, quota, etc. So, I think Customs has an obligation in this new environment to tell the trading community ahead of time, what will be the country of origin for a given good based upon the substantial transformation principle. We think that the use of tariff shift rules, coupled with a few conditions, achieves this goal while providing the needed predictability, transparency, and objectivity in country of origin determinations. We have solicited comments from the trade on the new rules, some of the comments, which are consistent with the substantial transformation principle, will be incorporated into the rules if they are made final. Our goal in this exercise is simple: to maintain the law established by the courts under the substantial transformation principle, while providing to the community ahead of time, the country of origin determination that they need to conduct their Customs business.

I thank you Mr. Chairman for your time, and I will be happy to answer [or get the answers] to any questions you or the members may have.

Chairman CRANE. Thank you, Mr. Banks.

Let me say at the outset that we are, Mr. Simpson, contemplating trying to craft legislation in subcommittee before the month of July is out—it probably would not be considered on the floor until after Labor Day—but with the explicit intent of trying to provide some better guidelines in terms of interpretation.

Let me ask you, Mr. Lang, for openers, what are the prospects in your estimation of WTO completing the program within a 3-year timeframe?

Mr. LANG. Well, it is a little hard to say at this point. I think we will have to get another few months down the road, see how the technical process is going, before we can be sure about that. That is the schedule we have agreed to and all other countries have agreed to. We are going to do our level best to keep up with it. We are going to get the technical requirements out there.

I think in some ways this country knows more about the tariff shift process that Commissioner Banks described than anybody else, and that may help us to move the process along a little quicker, because there is, I sense, a feeling of consensus that we do need transparency in these rules of origin, which are on nonpreferential trade. So that is our target, but I think it is too early to predict it now.

Chairman CRANE. You mentioned, if I am not mistaken, Mr. Simpson, 5 years was your projected estimate. What do you base that on?

Mr. SIMPSON. Well, the World Customs Organization, which is charged with developing these rules, has 3 years to develop tariff shifts that would represent substantial transformation. In fact, I think it would not be in our interest to terminate that process at 3 years if the work is not done. If the work is not done—and I am fearful that it will not be—I think we should continue to pursue that process for the very reason Mr. Lang gave. We are the experts on using the tariff shift approach to develop rules of origin. If we terminate that process prematurely, I am afraid we are going to default to a European system, which uses other criteria that are less advantageous to us.

Once that process is completed, it will take another year or so for the World Trade Organization to resolve any disputes that the Customs Organization has not been able to sort out among themselves at the technical level, and then the national legislatures around the world will need another year beyond that and one session of Congress to implement the agreement and to give people a little advance notice of its effects.

So that is how I got at least 5 years for the effective date.

Chairman CRANE. Mr. Lang, in your estimation, is there a commitment to negotiate in good faith on the part of our trading partners?

Mr. LANG. Yes.

Chairman CRANE. You do not have any reservations?

Mr. LANG. Well, we did at the very beginning, but yes, sure, we all signed on to the Uruguay round, and I do not detect any reason to believe that they will not come forward in good faith.

Chairman CRANE. Getting back to you, Mr. Simpson, if this could be a target hit in 3 years, why are we adopting new U.S. rules at this point instead of waiting until the completion of that?

Mr. SIMPSON. Well, under no circumstances can the rules become effective in 3 years. Three years is the minimum timetable within which the World Customs Organization will complete the first part of the process. There will be additional time after that required for the World Trade Organization to sort out disputes and for national legislatures around the world to enact whatever agreement is reached.

I think at a minimum it will take at least 5 years to do that. During that period of time, the question is: What sort of a system do we want the U.S. trade community to be operating under? I think, although this may not be apparent to you from the witnesses you have here today, a large majority of industries are interested in a system that tells them up front what the position of the Customs Service will be so that they do not have to find that out after the fact, after they are committed to a trade transaction.

Chairman CRANE. Well, I understand that, but hopefully we can give you some legislative guidelines before this year is out.

I would at this point like to defer to our distinguished ranking minority member who was delayed getting here, but we started in your absence, anyway, Charlie. So Mr. Rangel would like to, I am sure, speak to all of you.

Mr. RANGEL. Let me yield to you, Mr. Chairman. I apologize to all the witnesses for being late. I am very interested in the comments that you have as to how we can make trade a lot easier and what regulations and laws we should be thinking about. So rather than hold you up any further, I would like to yield back to the chair at this time.

Chairman CRANE. Thank you. Let me also reassure everyone in the room that anyone interested in testifying on this subject matter was invited to come testify. I mean, we were not simply taking objectors.

With that, let me yield to Mr. Hancock.

Mr. HANCOCK. I do not have any comment.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and I want to thank the witnesses for helping us to understand this complex and difficult subject.

Mr. Simpson, you said in your testimony that there were two kinds of recommendations that you might make, I suppose, in general or to industry or to this subcommittee. You mentioned the coffee industry and specifically said that in the near term a recommendation might be that they would be exempt from a system such as this. The second kind of recommendation you said had to do with the whole idea of substantial transformation, but yet you at the end said there were some caveats associated with that particular recommendation.

For my benefit, since we do not have any written testimony, could you go back over that so that I might understand it just a little better?

Mr. SIMPSON. Let me start by explaining the concept of substantial transformation. It is a court-made rule to define the cir-

cumstances under which a product converts from one country of origin to another. When an article is processed to such an extent that it is considered to be substantially transformed, it requires a new country of origin.

The problem is that this concept, which worked well in the last century and the early part of this century, does not work as well in an economy in which goods are processed in increments in two or more countries and in which materials can come from all over the world. No single country may substantially transform the article. Even if one country does, the recordkeeping that is required to keep track of all those parts and where they come from for an industry like the electronics industry is formidable.

Nonetheless, we are required to force fit laws, like the country of origin marking law, that go back well into the last century, we are required to force fit those onto a modern economy. Frankly, I have a lot of sympathy for the electronics industry, and even for the coffee industry when they are buying coffee from all over the world, with the problems they have in trying to keep straight where their components and materials come from. So one of the things Congress could do is prescribe a different standard other than substantial transformation for these industries.

The second thing I suggested is that in some cases an industry could be exempted from a law altogether. Country of origin marking for coffee may not be of interest to the American consumer. I think most American consumers know that, with limited exceptions, the coffee they drink is from outside of the United States. Whether Congress considers that the American consumer still has an interest in country of origin marking for every industry is a question that I think perhaps ought to be revisited by the Congress.

Mr. PAYNE. When you say something other than substantial transformation, what are some of the other criteria that you might suggest to the subcommittee?

Mr. SIMPSON. Last place of assembly, for example, so that wherever a complex electrical machine is last assembled, that would be the country of origin.

Mr. PAYNE. The amount that was done at that assembly point would not be relevant to this particular criterion?

Mr. SIMPSON. Yes, sir. That is correct; it would not be.

Mr. PAYNE. Thank you very much. Mr. Chairman, I have no more questions.

Chairman CRANE. Mr. Rangel.

Mr. RANGEL. If we cannot wait for the WTO, and it seems as though all of you, I think, believe that Congress should move more swiftly, I assume that you have proposals that have been submitted to staff and to the subcommittee as to what you think would make these rules in determining origin and marking easier?

Mr. SIMPSON. Mr. Rangel, I am a career civil servant, and I am limited by bureaucratic ways of thinking. I have not had any idea more bold than the one I put forward in the regulations we published for public comment over 1 year ago. That is that we would move away from an environment in which we were giving people decisions on a case-by-case basis, after they had already committed themselves to business contracts, to an environment in which the

rules would be published and people could see up front what they were, and in which we could not change the rules without going out for further public comment. That is the best idea I have because that is all I have the power to propose.

Now, beyond that, although I had not thought of this before, we would certainly be willing to work with the Congress and industry groups represented here today to suggest legislative changes that could have more sweeping effects.

Mr. RANGEL. What impact would the legislation have on other countries if we did do it?

Mr. SIMPSON. I think the primary effect is not on other countries, but on this country. The primary effect is that laws enacted by Congress to discriminate against imported goods, either in a positive way or a negative way, would not have the effects that were intended by Congress at the time those laws were enacted.

Now, perhaps Congress wants to revisit those laws. Perhaps the objectives of those laws are no longer of interest to Congress. But we in the executive branch just do not have the power to substitute the standards that have been used for over a century by our courts and to impose one of our own. Congress has to do that for us.

Mr. RANGEL. Well, I am new on this committee, but you are suggesting that because of the changes in society it is very complex to try to determine whether the points of origin are that important or how we can make it easier for you in the executive branch. I assume that my chairman, with all the time he has had in the minority in understanding all these small problems, would be the—[Laughter.]

He would be in a better position to assist the administration. But I do hope that you feel comfortable in making, all of you, whatever suggestions that you have so that at least we do not try to change the world but try to change what you think is necessary so that you can do your job a lot easier.

Thank you. Thank you, Mr. Chairman.

Chairman CRANE. Sure thing.

Mr. Zimmer. Mr. Ramstad, you are after Mr. Zimmer, in order of appearance.

Mr. ZIMMER. Thank you, Mr. Chairman.

Mr. Lang, I would like to ask some questions about the rule of origin applied to imported clothing. This is somewhat unique because it was specifically included in the Uruguay Round Act as proposed by the administration, and I understand with the support of USTR, the U.S. Trade Representative. It changed the definition of the origin of clothing to be the country in which the garment is assembled instead of the traditional rule, which is the country in which the cutting of the fabric takes place.

First of all, a process question. I understand that this specific provision was rejected by the Senate Finance Committee, yet it was included in the legislation proposed by the administration despite the fact that the fast track requirement limits amendments to "necessary and appropriate measures."

Could you explain why that happened?

Mr. LANG. I am afraid I cannot because I have only recently been sworn in and I was not here for the battle over that. But if I can

respond in writing to you after the hearing, I will find out what the answer is and get back to you.

Mr. ZIMMER. I would appreciate that. I know there is going to be testimony from a clothing importer later on about the tremendous disruption and what he considers to be the increased costs to the consumer that are being caused by this change.

Are you familiar enough with it to justify it as a matter of policy?

Mr. LANG. I am afraid I am not. I regret that, but I am new on the job, and I am just not familiar with that particular problem.

Mr. ZIMMER. OK. I would appreciate your responding in writing on that.

Mr. LANG. Thank you very much.

[The following was subsequently received:]

Hearing on Rules of Origin Before the Ways and Means Trade Subcommittee
July 11, 1995

Response for the record to questions of Mr. Zimmer

Q.1. Regarding the inclusion of language in the Uruguay Round Agreements Act on rules of origin for certain textile and clothing products.

Answer: The provision included by the Administration in the draft Uruguay Round Agreements Act was a compromise between the views of the House and the views of the Senate. The House Committee on Ways and Means passed, on a 24-12 vote, an amendment which would have legislated an "assembly" rule of origin, with an effective date of January 1, 1996. The Senate Finance Committee debated a similar amendment, but the amendment was ultimately defeated on a tie vote, 10-10. It was left to the Administration to find a compromise between the two positions.

Among the arguments made by members of the Senate Finance Committee who were opposed to the amendment were: 1) that such rules of origin should not be adopted by the Congress but should be established through a traditional rulemaking process; and 2) concern that a January 1, 1996 date may be too soon for some importers and retailers to adjust to revised rules of origin.

Therefore, the Administration in devising a compromise made three changes to the position of the House: 1) it established that the changes to the rule of origin on textiles and clothing would be made through a rulemaking process, thereby allowing comment from all interested parties on such terms as what constitutes "assembly" and "most important assembly", as well as comment on the specifics of the individual tariff lines involved; 2) it modified the effective date of the rule of origin such that the new rules would not be effective until July 1, 1996; and 3) it included a provision making it clear that the new rules would not apply to goods imported on or before January 1, 1998 if such goods were covered by a binding contract entered into on or before the date the House Ways and Means Committee adopted the amendment for a change in rules of origin (July 20, 1994).

Q.2. Regarding the justification for the change in the rules of origin and concerns regarding potential disruption to clothing importers.

Answer: The major concerns that were expressed by members of both the House and the Senate in debating the rule of origin amendment were: 1) that basing a rule of where a garment was made solely on where the fabric was cut did not appear to be justified by economics of the process, and 2) that a "cutting" rule was far from the norm in the rest of the world. The argument was made that cutting fabric constitutes less than 5% of the overall cost of producing a garment. Therefore, many members expressed the view that "cutting" should not be the sole test of where a garment was made, particularly given the development of new technology in fabric cutting (i.e., laser cutters) which permit very significant volumes of fabric to be cut on a single machine. This has permitted machines to be installed in one country, with pieces being cut in that country, but all the other work of sewing, labelling, finishing and packaging done in a second country, yet the goods being considered made in the first country.

Second, the concern was expressed that it is virtually impossible for Customs to enforce a cutting rule, whereas a rule based on assembly can be more easily verified by Customs teams which do plant verifications to ensure that given facilities are capable of producing the volume of goods that they claim are being exported to the U.S.

Finally, there are provisions under the WTO agreement which will require USTR to hold consultations with all requesting countries with whom we have a bilateral textile agreement to determine what adjustments, if any, are necessary to the quota levels to account for the rules changes. Such changes in quota levels may ameliorate significant disruption.

Mr. ZIMMER. Mr. Simpson, I would like to know how the Treasury Department responds to the charge by several industries represented here today that the proposed interim rules are in violation of the WTO Agreement on rules of origin.

Mr. SIMPSON. Well, I am not sure that I understand the specifics of that charge. The WTO Agreement envisions that all countries will move toward a system of rules of origin that are predictable and transparent and that are published for the benefit of the public. We have never done that before. We have always made origin determinations on a case-by-case basis. This is the first time we have had origin rules that were published and in the public eye, and the first time we have had a system in which changes could only be made if public comment was sought.

I would point out, as Commissioner Banks did, that we have made an extraordinarily conscientious effort to ensure that the rules we published did not change any of the rulings or court decisions that have been issued in the past. There were some exceptions where there were contradictions between two decisions, but except in those cases and maybe one or two others, I think we have been very conscientious not to change the status quo.

Mr. ZIMMER. I will yield back my time so Mr. Ramstad will have a chance to ask before we vote.

Chairman CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. I am just glad my appearance is duly noted, Mr. Chairman, albeit out of order. I will ask you after the subcommittee hearing what that means.

Thank you to all the witnesses. Mr. Simpson, we know that Customs is proposing new rules of origin for textile and apparel articles pursuant to Breaux-Cardin, and a number of us on the subcommittee and the full committee have some serious questions about these rules that are being promulgated. Also pursuant to article 311 of NAFTA and the NAFTA Implementation Act, Customs published the NAFTA marking rules. So, arguably, for each there is congressional authority.

However, I am at a complete loss to determine what basis Customs is using to make the NAFTA marking rules effective as a rule of origin for all goods from all foreign countries. They are talking about all goods from all foreign countries. I am just wondering if you could elaborate, because there certainly does not seem to be any direction from Congress to do this.

Mr. SIMPSON. Congressman, the Treasury Department is charged by the Congress with implementing a number of laws that require origin determinations to be made, but the oldest of those laws are the revenue laws. It was not until 1914 that we had an income tax in this country, and prior to that time, the national government of the United States was supported by customs duties. So there are some very ancient laws, going back to the earliest days of our Republic, that require the Customs Service to make origin determinations.

The authority that the Secretary of the Treasury has to implement those laws are also equally ancient, and I think the best one appears in title 19 of the U.S. Code in section 3, and it says essentially—and I am paraphrasing here—that the Secretary of the

Treasury shall administer the revenue laws of the United States as he sees fit.

Basically, what we are doing in this case is trying to administer the revenue laws and other laws that Congress has charged us with carrying out in a way that is as transparent and as predictable as we can for the benefit of the U.S. trade community.

Mr. RAMSTAD. So perhaps your response calls for further legislation. You look at the standard that was discussed earlier, the substantial transformation standard. We all know that the courts apply the standard on a case-by-case basis. Under Customs proposal to universalize, you might say, the NAFTA marking rules, what role do you think, if any, the courts would play in reviewing these determinations?

Mr. SIMPSON. Well, the courts would have the role they always play in reviewing regulations issued by the executive branch, and there are a number of court decisions that set forth the standard for review. I think the traditional test is whether the regulations we have issued are well suited to the law, to the intent of Congress, and whether we have been arbitrary and capricious in the regulations that we published.

I would reiterate that the absence of these regulations we published does not change the substantive standard that Customs will apply. In other words, the decisions will come out the same way. It is just that no one in the trade community will know in advance because we would not have published any rules that would enable them to know in advance how Customs will make those decisions. So this is not a question of substance. This is not a question of how origin determinations will come out. This is simply a question of how transparent the executive branch is willing to be in its dealing with the trade community.

Mr. RAMSTAD. I had a couple other questions, but given the timing on the vote, I will yield back, and thank you for your responses.

Chairman CRANE. Mr. Neal, do you have any questions for this panel?

Mr. NEAL. No, Mr. Chairman. Thank you for recognizing me. Listening to the debate on the floor yesterday, I am happy to have this seat. [Laughter.]

Chairman CRANE. Well, with that, then I thank this panel for its appearance before the subcommittee.

I would like to ask the next panel to get comfortable up here. That is Richard Ayers, Evelyn Suarez, Matthew McGrath, and James McCarthy. I would like to recess after you folks are situated. I would like to recess for the vote that is in progress, but I want to defer to our distinguished colleague from Connecticut, Mrs. Johnson, to welcome Mr. Ayers before we go.

Mrs. JOHNSON. Thank you, Mr. Chairman. I appreciate this opportunity to welcome my constituent, Dick Ayers, who is the chief executive officer of Stanley Works of New Britain, Conn. I welcome him here because I have worked with him over many years as Stanley has truly become an international company at the cutting edge of competition and have worked with him on counterfeiting issues. We have successfully here in Congress changed the laws to strengthen our anticounterfeiting laws and have succeeded in preventing dumping of certain counterfeit products into our markets

and, therefore, preserved not only an important manufacturer but American jobs.

I was very interested in Mr. Simpson's comment that he does not think that they are substantially altering the way Customs has proceeded in the past, because we certainly feel that some of the decisions they have made have substantially altered the definitions that have regulated decisions about origin in the past, and our fear is that if these problems are not addressed, it will force the export of American jobs.

Mr. Ayers will make the case in far greater specificity than I have time or abilities to make now, but I believe this is a very important hearing; and if Congress does not keep on top of these issues between now and the 5 years hence when we might have a harmonization of the national rules of origin, which I think is in all of our interests, then I think we will in that interim lose critical American manufacturers, which we can ill afford to lose.

So I welcome Mr. Ayers and the next panel, and I am sorry that I will not be able to return.

Chairman CRANE. I thank you for your comment, and if you folks will excuse us, we stand in temporary recess to make a vote. We will be right back.

[Recess.]

Chairman CRANE. If everyone will be seated, we shall recommence.

Mr. Ayers, our distinguished colleague, Mrs. Johnson, has a conflicting committee session so she apologizes for her inability to stay for your testimony. But we will yield to you first. To all of you, if you can keep it under 5 minutes, anything beyond that will be made a matter of the permanent record.

Mr. Ayers.

STATEMENT OF RICHARD H. AYERS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, STANLEY WORKS, NEW BRITAIN, CONN.

Mr. AYERS. Thank you, Mr. Chairman. As I mentioned, I am from Stanley Works, a producer of tools, hardware, and specialty hardware items for home improvement, consumer, industrial, and also professional use. I appreciate this opportunity to testify before your subcommittee on rules of origin, a subject that has a great impact on Stanley and its plans for expansion.

Stanley is a 152-year-old company with 114 manufacturing and major distribution facilities in 20 countries and sales in virtually every country of the world. We are headquartered in New Britain, Conn., and last year the hard work and determination of our 20,000 employees resulted in sales that exceeded $2.5 billion. We are proud that the name Stanley has long been an industry standard for quality.

Stanley's experience has convinced us that either the origin rules need to be reexamined or Congress should provide guidance to the administrators of these rules. The rules must be understandable, predictable, and accurately reflect the value added by the manufacturing operations where the finished products are made.

As interpreted and applied by the Customs Service to Stanley's products, the rules do not satisfy these requirements. Moreover, in Customs proposal to extend the NAFTA rules of origin to

nonpreferential issues, Customs has ignored the value-added concept and rejected court decisions on substantial transformation with which it disagrees.

Stanley has built and coordinated its manufacturing operations in reliance on longstanding court decisions and Customs Service administrative rulings which hold that, when imported forgings undergo significant processing in the United States which changes the name, character, or use of the articles, thereby effecting a substantial transformation, the completed tools are not deemed to be the product of the country where the forgings were made and need not be marked as having been made there.

While some of the tools sold by Stanley are produced entirely from U.S. raw steel, many are manufactured from imported rough forgings made at facilities operated by Stanley affiliates or others at overseas locations. However, in the United States, all of them undergo machining operations: drilling, lathing, broaching, chamfering, milling, and other metal removal by which they achieve their functional shape and fit. After machining, they are subjected to multistep heat treating which alters their metallurgical and chemical properties, and they become a different material in terms of strength, durability, and toughness. Extensive surface preparations follow, ending with nickel and chromium electroplating to make the tools easy to handle, easy to clean, and resistant to corrosion.

I have brought with me an imported forging from which we make a 9/16 combination wrench. That is a flat wrench with both an open end and a box end. I have also brought a sample of the article after it passes through each of the seven work centers in which it is processed in our Wichita Falls, Tex., plant. I invite you to examine the imported forging itself and the article after it passes through each of the work centers in Wichita Falls. Maybe I could just get these brought up to the subcommittee, and you will notice that one would work as a wrench and the other will not.

These operations account for a large percentage of the total cost of production and greatly add to the value of the article. Where tools like these are made is an important consideration of many of Stanley's customers. They believe that the quality they demand of hand tools is associated with being American made. All of the important attributes of our mechanics tools which make them desirable to our customers—the precise fit, the strength, toughness, durability, and lasting value—are accomplished in our Dallas and Wichita Falls plants by our skilled American work force. To represent these high-quality tools as being the product of some foreign country simply because the initial forging step had been performed there would actually be misleading.

Recently, the Customs Service has proposed a radical change in the law, one which would declare that if the shape of an imported forging establishes its ultimate intended use, there is no substantial transformation which can occur irrespective of the extent of the postimportation operations or of the value added in the United States. Customs has threatened to withdraw the ruling letters on which Stanley has relied in developing its mechanics tool business and require the finished hand tools be marked with the country where the forging was made.

The Customs proposal is impossible to comprehend. It ignores economic and market realities. If we are compelled to mark the country of origin of the forging on the finished products, it would make sense to move all of the related American jobs and investment away from the United States. This should not be the policy of our Government.

Finally, Stanley believes it is appropriate for this subcommittee to examine the effect on international trade of origin-marking rules administered by other agencies. The Federal Trade Commission, NAFTA, and Customs have different rules which result in confusion to our customers, added expense in duplicate inventories, and uncertainty in investment and employment decisions. Stanley's foreign competitors do not operate with these handicaps. We urge you to examine this problem as well.

This concludes my testimony, and I very much appreciate the opportunity to present Stanley's views on this very important issue. I would be pleased to respond to any questions you have after the other panelists have made their presentations.

[The prepared statement and attachment follow:]

Testimony of Richard H. Ayers
Chairman and Chief Executive Officer, The Stanley Works
on Rules of Origin
before the
Subcommittee on Trade
Committee on Ways and Means
July 11, 1995

Mr. Chairman and members of the committee. I am Dick Ayers, Chairman and Chief Executive Officer of The Stanley Works, a worldwide producer of tools, hardware and specialty hardware for home improvement, consumer, industrial and professional use. I appreciate the opportunity to testify before your committee on rules of origin, a subject that has had, and will continue to have, a great impact on our company and its plans to expand manufacturing in the United States.

To begin with, let me give you a thumbnail sketch of our company. The Stanley Works is a 152 year old company with 114 manufacturing and major distribution facilities in 20 countries and sales in virtually every country of the world. We are headquartered in New Britain, Connecticut. Last year, the hard work and determination of our 20,000 employees resulted in sales that exceeded $2.5 billion. We are proud that the name Stanley has long been an industry standard for quality. This reputation for reliability has provided the foundation for our company's growth from a small manufacturer of fine tools and hardware into a global competitor. We are committed to maintaining this reputation and achieving success in the United States and abroad.

In recent years, we at Stanley have become all too familiar with U.S. rules of origin, the substantial transformation test, and now proposed origin rules based on changes in tariff classification. The experience has convinced us that either U.S. origin rules need to be re-examined and rethought or that Congress should provide guidance to the administrators of these rules. It has also demonstrated to us, as our global business grows, that the harmonization of worldwide rules of origin is essential. A key element for any business faced with the decision of whether to invest in plant, equipment and people is whether applicable Government origin rules are understandable, uniform, certain, and accurately reflect the contribution made by the manufacturing operations in the last country in which the finished product was processed. As currently applied by the Customs Service to our products, U.S. country of origin rules do not meet these criteria.

We were pleased at the prospect that the North American Free Trade Agreement rules of origin for determining entitlement to preferential duty rates would be extended by the Customs Service to rules of origin for determining non-preferential issues. The preferential rules nearly meet our three criteria: they are more understandable and provide greater certainty than the substantial transformation test as administered by Customs; and, through application of a value-added concept -- the regional value content test -- they adequately reflect the contribution of processing in the last country. Unfortunately, the proposed non-preferential rules of origin do not mirror the preferential rules. By eliminating the value-added concept, by adding new, ambiguous, confusing interpretative rules, and by refusing to follow judicial decisions on substantial transformation with which it disagrees, the Customs Service has created rules that, if adopted, would be extremely prejudicial to Stanley and would pose a serious threat to the economic vitality of a major segment of our business.

The treatment of our mechanics hand tools is a prime example of the difficulties we have encountered with Customs' administration of current U.S. rules of origin. These tools also provide a good example of how the tariff change

approach would operate under NAFTA preferential and non-preferential rules. Although Stanley is perhaps best known for its line of wood working hand tools and hardware items, we are also a leading manufacturer of mechanics hand tools in the United States. These tools, which consist mainly of socket wrench sets and components and flat (open-end, box-end and combination) wrenches, are of high quality, and are produced to meet the exacting specifications established by various standard-making bodies including the federal government. These tools are sold under various brand names owned by Stanley as well as under the private brands of retail marketers. Stanley manufactures these tools at plants located in Dallas and Wichita Falls, Texas, and Sabina, Ohio and maintains large distribution centers at Covington, Georgia, and Columbus, Ohio. These facilities collectively employ about 1,800 people.

Where the mechanics tools are made is an important consideration for many of Stanley's customers. Unlike the users of many products, there is strong belief among end-users of hand tools that the quality they demand is associated with being American-made. While some of the mechanics tools sold by Stanley are produced entirely from raw steel feedstock in the U.S., many are manufactured from imported rough forgings made at facilities operated by Stanley affiliates or others at overseas locations. This enables us to have unpleasant, low-skilled, lower value tasks performed elsewhere, and to have the higher skilled, more technical tasks performed here.

Forging is a hot, dirty, noisy operation performed on forging presses, drop hammers or formers, where, in a single operation soft steel is pressed into a shape as close as possible to the contour of the finished tool. Forging is used as a first step to minimize the amount of steel wasted. The better the forging process, the more closely the forging will resemble the finished product. Although the forging may look somewhat like the desired tool or tool component, the forging itself cannot be used any more than the raw material from which it was formed. The forging lacks the physical and material characteristics essential for a mechanics tool.

Since the early 1980s, Stanley has built and coordinated its mechanics tools manufacturing operations in reliance on existing law reflected in long-standing court decisions and in Customs Service administrative rulings based on those decisions. Those court decision and administrative rulings declare that when imported forgings undergo significant processing in the United States which changes the name, character or use of the articles, thereby effecting a "substantial transformation," the finished tools are not deemed to be the product of the country where the forgings were made and need not be marked as such when offered for sale.

The specific manufacturing processes performed by Stanley in the United States vary from item to item. However, all of them undergo machining -- drilling, lathing, broaching, chamfering, milling or other metal removal operations -- by which they achieve their functional shape and fit. Next they are subjected to sophisticated multi-step heat treating processes by which their metallurgical and chemical properties are altered so as to become a different material in terms of strength, durability and toughness. That is followed by extensive surface preparation ending with nickel and chromium electroplating to make the finished tools easy to handle, easy to clean, and resistant to corrosion. Some of the tools also require further assembly operations. All of these manufacturing operations, which are essential to produce end products capable of functioning as hand tools and being marketable as such, account for significant percentages of the total cost of production.

The substantiality of the transformation effected by Stanley's domestic manufacturing operations is also evidenced by the significant value added to the

imported forgings, a criterion that has long been recognized by the courts as relevant. While the figures vary to some degree with respect to the different tools, utilizing the regional value content standard of the North American Free Trade Agreement, all of our hand tools qualify for the duty preference based on the value added to the forgings by the operations performed in the United States. This means that over 60%of the transaction value of the tools, in other words, the price to an unrelated buyer, is attributable to U.S. parts, processing and labor. For example, the blank forging imported for a Double Box End Wrench costs $.9030. Since the typical selling price is $6.04, the finished tool reflects an increase in value of 569% over the imported forging. Similarly, the cost of a forging from which a one-half inch drive 1" standard socket is $.2549, or only 6.2% of the sale value of the finished product.

From the standpoint of our customers in the United States, the important attributes of the tool which make it desirable -- the precise fit, the strength, toughness, durability and lasting value -- are attained in our Texas plants by our skilled American workforce. To represent or pass off these high quality finished tools as having been made in a foreign country simply because the initial forging had been performed there would actually be misleading and a disservice to the consuming public.

If we are compelled to mark the country of origin of the forgings on the finished products, it would also make sense to move all the related United States jobs and investment away from the United States. This should not be the policy of our Government.

Recently, the Customs Service proposed to advance a new rule, one which declares that if the shape of the imported forging establishes its intended end use, then no substantial transformation can occur irrespective of the extent of the post-importation operations performed in the United States or of the value added by such operations. To implement this new rule Customs has proposed to revoke and withdraw the ruling letters on which Stanley has relied in developing its mechanics tools business, including three ruling letters issued either to Stanley or its predecessors and dealing specifically with the manufacturing processes now employed by Stanley. As a rationale for this new position, Customs cites language in a decision of the Court of International Trade, National Hand Tool v. United States, Slip Op. 92-61 (April 27, 1992) aff'd 989 F.2d 1201 (Fed. Cir. 1993). That case, however, involved tools that were different from those covered by the ruling letters, and tools whose manufacture involved none of the U.S. machining operations that had traditionally been held to be important criteria in determining whether substantial transformation had occurred. Thus, in the face of a long history of consistent rulings that significant machining and metallurgical processing transforms a useless piece of steel into a commercially useful hand tool, Customs would now require the finished hand tools to be marked with the country where the forging process gave shape to the piece of steel. As the head of a successful American manufacturing company, I find Customs' proposal impossible to comprehend.

Customs' proposed revocation of our rulings also illustrates the vagaries and uncertainties of the substantial transformation test. The test has been criticized as being very subjective. Our experience in this matter, with the sudden jettisoning of the major criterion on which our rulings were based, supports this criticism. Business flourishes in a climate of certainty, when Government rules and regulations are stable. Uncertainty creates more risks for business and thus hampers and retards investment.

The North American Free Trade Act's rules of origin for determining whether a product is made in the U.S., Canada or Mexico and therefore is entitled to a preferential duty rate, although far from perfect, appear to eliminate many of the

uncertainties inherent in the substantial transformation test and offer a sound model for both U.S. non-preferential rules of origin and worldwide harmonized rules of origin. The NAFTA rules of origin are based on tariff classification change; that is, if the processing of an imported product in a NAFTA country results in a specified change in tariff classification, that country is deemed to be the country of origin. In certain instances, where a good does not undergo a tariff classification change in spite of extensive processing in a NAFTA country, the finished article may still qualify for the NAFTA preferential tariff if the regional value content of the good is not less than a specified percentage. In other words, the finished article will qualify for preferential duty treatment if sufficient value is added in one or more of the NAFTA countries. We support a value-added approach as a fair standard for preferential and non-preferential purposes.

On the other hand, we are very much opposed to the Customs Services' proposed non-preferential rules of origin, published as Part 102 of the Customs Regulations. Although the proposed non-preferential rules are based on the NAFTA rules of origin, the value-added concept has been totally eliminated from consideration in determining whether sufficient processing has occurred in a country to confer origin. Thus, as applied to our mechanics hand tools, the Part 102 rules would classify forgings under the provision for finished mechanics tools and ignore the substantial processing of, and enormous value added to, the forgings in the United States. Stanley would be required to mark the finished hand tools with the name of the country where the forgings were made.

Our company is actively participating in the International Trade Commission investigations into whether the tariff classification change approach as reflected in the Part 102 rules leads to different results than the substantial transformation standard. I have attached, for your consideration, technical comments submitted by us to the ITC in response to their investigation. Stanley has identified several major shortcomings in Customs' approach. In summary, the Customs Service proposed rules of origin fail to codify existing and longstanding case law and Customs rulings and introduce new and vague concepts that are themselves highly subjective and therefore create uncertainty for industry. Moreover, these new concepts are inconsistent with or simply ignore the principle of substantial transformation and would certainly invite protracted litigation over the legality and interpretation of the rules. Obviously, these rules would have a negative effect on international trade and investment.

In preparing our submission to the ITC, Stanley requested origin opinions from its attorneys in Japan, the United Kingdom, Germany, France and Canada using various scenarios. While the results of this informal survey support the need for international harmonization of rules of origin, each legal opinion indicated that even where manufacturing operations did not result in a change of classification, other factors were considered to determine whether the operations resulted in a substantial transformation. These opinions suggest that our major trading partners will likely support the use of supplementary criteria based upon a value-added concept, specific manufacturing processes, or other standards, where the change in classification approach does not reflect a substantial transformation.

Finally, Stanley believes it would be appropriate for this committee as part of its rules of origin review to examine the effect on international trade of origin marking rules administered by other U.S. Government agencies such as the Federal Trade Commission. We submit that many of these rules are archaic and have no place in the international marketplace. Often they are complex, confusing and inconsistent, and place U.S. manufacturers at a competitive disadvantage with their foreign competition. For example, a mechanics tool manufactured in the United States using some foreign components may not be marked "Made in USA", as the usage of that term is defined by the FTC, but the countries of the European Union

or Canada would require the tool to be so marked. Two different markings result from application of the NAFTA preferential duty rules and the Part 102 rules of origin. The same tool, subject to the same processing, would have to be marked "Made in USA" for the Canadian and Mexican markets, but would have to be marked with the name of the country where the forging was produced if sold in the U.S. market. On the other hand, if the same tools were made in Canada or France, for example, they could be marked "Made In Canada" or "Made in France", respectively, whether sold in the U.S. or the country of manufacture. Thus, the U.S. manufacturer would mislead his customers and would incur the cost of maintaining two sets of inventory: one for domestic sale and one for export sales. Our foreign competitors do not incur these costs and difficulties with customers. We urge you to look at this very serious problem for business caused by the inconsistent and confusing origin rules of the federal government and adopt the standards used in NAFTA for all country of origin purposes, including the laws administered by the Customs Service and the Federal Trade Commission.

This concludes my testimony. I very much appreciate the opportunity to present Stanley's views on this very important issue. I would be pleased to respond to any questions you may have.

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June 14, 1995

Office of the Secretary
United States International Trade Commission
500 E. Street, S.W.
Washington, D.C. 20436

Re: Investigation No. 332-360 — International Harmonization of Customs Rules of Origin

Dear Madam Secretary:

On behalf of The Stanley Works, 1000 Stanley Drive, New Britain, Connecticut, we hereby submit the following in response to the Commission's request dated April 19, 1995, for comments on the Rules of Origin published by the U.S. Customs Service as Part 102 of the Customs Regulations (19 C.F.R. Part 102).

A. Introduction

The Stanley Works ("Stanley") is a worldwide producer of tools, hardware and specialty hardware for home improvement, consumer, industrial and professional use. Stanley has 114 manufacturing and major distribution facilities in 20 countries and has sales in virtually every country of the world. Stanley has exported goods from the United States for more than 100 years and established its first manufacturing facility outside North America in 1920.

As a truly global enterprise, Stanley has a strong interest in the establishment of uniform rules of origin as envisioned by the Uruguay Round Agreement on Rules of Origin. The existing system, where each country or trading bloc in each of the world's major markets has a different set of origin rules, presents significant problems for an international business such as Stanley. There are necessary, additional manufacturing and administrative expenses associated with producing identical products with different origin markings and maintaining and controlling separate inventories in order to comply with the origin marking laws in each jurisdiction. Origin rules also affect investment and trading decisions by international companies. *See* Jackson and Davey, Legal Problems of International Economic Relations, 2nd Ed. at 386. Stanley strongly supports the efforts of the World Trade Organization (WTO) and the World Customs Organization (WCO) to bring order to this confusing and costly situation.

In the notice announcing the Commission's investigation, the Commission requests comments on the Rules of Origin published by the U.S. Customs Service as Part 102 of Title 19 of the Code of Federal Regulations. Specifically, the Commission has asked for instances in which Customs' change of tariff classification approach leads to different results than the substantial transformation standard. Stanley has identified several major shortcomings in Customs' approach. In particular, the proposed rules of origin fail to codify existing, longstanding case law and Customs rulings, introduce new and vague concepts that are inconsistent with or simply ignore the principle of substantial transformation, and would certainly invite protracted litigation over the legality and interpretation of the rules even while Customs and the Commission contemporaneously seek to use the rules as the basis of the United States' position in the forthcoming negotiations. The proposed rules must be revised to correct these shortcomings.

B. Discussion

1. The Commission should expand its investigation to consider the harmonization of all origin marking rules enforced by the U.S. Customs Service, the Federal Trade Commission and other government agencies.

Stanley suggests that the Commission investigate the current country of origin marking rules enforced by Customs, as well as origin marking rules administered by other U.S. government agencies such as the Federal Trade Commission. Stanley believes that many of these rules are archaic and have no place in the international marketplace. Moreover, their complexity and confusing nature place U.S. manufacturers at a competitive disadvantage with their foreign competition. For example, a product manufactured in the United States using some foreign components may not be marked "Made in U.S.A.," as the usage of that term is currently defined by the Federal Trade Commission, while the countries of the European Union or Canada would require the good to be so marked. On the other hand, if the same goods were made in Canada or France, they could be marked "Made in Canada" or "Made in France," respectively, whether sold in the U.S. or the country of manufacture. Thus, the U.S. manufacturer incurs the cost of maintaining two sets of inventory: one for domestic sale and one for export sales. Its foreign competitors do not incur these costs. Essentially, U.S. manufacturers are forced to make production decisions based on the origin marking rules. If a company cannot mark a product "Made in U.S.A." regardless of the value-added in the U.S. and may, in fact, be required to mark the product as being of foreign origin, it has one less incentive to locate its manufacturing operations in the United States. This should not be the result of the U.S. origin marking laws.

2. The Rules of Origin proposed by U.S. Customs must be revised to correct several major shortcomings.

The Rules of Origin the subject of the Commission's investigation were published by Customs as the Interim Rules for Determining the Country of Origin for a Good for Purposes

of Annex 311 of the North American Free Trade Agreement ("Interim Marking Regulations") and the proposed Rules of Origin Applicable to Imported Merchandise ("Proposed Rules of Origin"). We will refer hereinafter to these rules as the "proposed rules of origin." Stanley is participating in the rulemaking process and commented on the proposed rules of origin at the time of their initial publication (59 Fed. Reg. 110 and 141 (Jan. 3, 1994)). Those comments, a copy of which are attached as an appendix hereto, discussed Customs' deviation from the stated intent of the proposed rules of origin "to codify the present country of origin rules." Customs recently published amendments to the proposed Rules of Origin and requested comments thereon (60 Fed. Reg. 22312). These amendments failed to address, and, in fact, aggravated, Stanley's original concerns. Stanley will respond to Customs amendments and will provide the Commission with the comments filed with respect to the amended Rules of Origin.[1]

Stanley's comments herein relate to the failure of the proposed rules of origin to address adequately three instances where goods will be manufactured or processed in the United States using materials, components or parts from foreign countries.[2] The first and second situations involve the further processing of unfinished or unassembled goods which, pursuant to General Rule of Interpretation (GRI) 2(a) of the Harmonized Tariff System, were classified as the finished or assembled good upon importation into the United States. The third situation occurs where a good is manufactured in the United States using components of foreign origin classifiable as parts of the finished good and, due to the structure of the Harmonized Tariff System, the finished good and its parts are classified in the same tariff heading or subheading. In all three instances, the proposed rules of origin determine arbitrarily that a substantial transformation can never occur regardless of the level of processing which might occur in the United States.

a. The GRI 2(a) Problems

GRI 2(a) of the Harmonized Tariff Schedule of the United States (HTSUS) states:

> Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as entered, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), entered unassembled or disassembled.

This rule addresses two distinct situations: 1) incomplete or unfinished articles and 2) articles presented unassembled or disassembled. The purpose of GRI Rule 2(a) and the distinctions between its two clauses are discussed in the Explanatory Notes to the Harmonized Commodity Description and Coding System (EN), which state (EN at 2)[3]:

[1] Comments on Customs' amendments to the proposed rules of origin are due on or before July 19, 1995 (60 Fed. Reg. 29520 (June 5, 1995)).

[2] While the shortcomings identified in these comments are discussed in terms of goods manufactured in the United States using foreign components, the same problems would arise in all situations where goods are produced in Country 1 and further processed in Country 2.

[3] The Commission should note that, with respect to the classification of blanks, the Customs Service interprets GRI 2(a) so broadly that the tariff provisions for forgings, such as subheading 7326.19, HTSUS (other articles of iron or steel: forged or stamped, but not further worked: other), are deprived of meaning.

> (I) The first part of Rule 2(a) extends the scope of any heading which refers to a particular article to cover not only the complete article but also that article incomplete or unfinished, provided that, as presented, it has the essential character of the complete or finished article.
>
> (II) The provisions of this Rule also apply to blanks unless these are specified in a particular heading. The term "blank" means an article, not ready for direct use, having the approximate shape or outline of the finished article or part, and which can only be used, other than in exceptional cases, for completion into the finished article or part.
>
> * * *
>
> (V) The second part of Rule 2(a) provides that complete or finished articles presented unassembled or disassembled are to be classified in the same heading as the assembled article. When goods are so presented, it is usually for reasons such as requirements or convenience of packing, handling or transport.
>
> * * *
>
> (VI) For purposes of this Rule, "articles presented unassembled or disassembled" means articles the components of which are to be assembled either by means of simple fixing devices (screws, nuts, bolts, etc.) or by riveting or welding, for example, provided only simple assembly operations are involved.

The application of the proposed rules of origin to determine the origin of goods classified using GRI 2(a) upon importation into the United States, or into another country, do not present a problem. The difficulty arises when the rules are used to determine the origin of the article produced using such goods. The following examples illustrate the situation.

Example 1 — Unassembled Goods

Company A imports into the United States all the components for an automobile engine except for the pistons and connecting rods. The country of origin of the imported components is Germany. Upon entry into the United States, Customs determines that the components possess the essential character of the complete engine and, through application of GRI 2(a), are classifiable as a complete automobile engine in subheading 8408.20 of the Harmonized Tariff Schedules of the United States (HTSUS). Company A subsequently obtains the pistons and connecting rods, then assembles the engine. The issue is whether the assembly of the engine in the United States results in a substantial transformation of the components so that the imported components will be excepted from the country of origin marking law (19 U.S.C. 1304).

This situation is governed by section 134.35 of the proposed rules of origin, which states:

> If an imported article will be used in further processing in the United States, the processor will be considered the ultimate purchaser if such article is determined to be a good of the United States under part 102 of this chapter. In such a case, the imported article is excepted from individual marking pursuant to 19 U.S.C. 1304(a)(3)(D) and § 134.32(d) of this part . . . .

If the imported article does not qualify for this exception, it must be marked with the country of origin at the time of importation ***and*** the processor must mark the finished product to disclose the origin of the imported components to the ultimate purchaser. Thus, the proposed rules of origin must be applied to determine whether the imported components are substantially transformed into goods of the United States when they are incorporated into the finished engine.

The hierarchical nature of the proposed Rules of Origin mandates application of each rule in turn until the origin of the product is determined. The first rule states that "the country of origin of a good is the country in which . . . [e]ach foreign material incorporated in that good undergoes an applicable change in tariff classification set out in § 102.20 . . . . " 19 C.F.R. § 102.11(a)(3). The tariff classification rules state that "a change to heading 84.08 from any other heading" results in a substantial transformation. Since the imported engine components were classified in heading 8408 by virtue of GRI 2(a), a change in heading does not occur when the components are assembled. The engine components do not undergo the requisite tariff classification change and, therefore, do not become goods of the United States through the assembly process. The origin of the components would remain Germany. Thus, Customs would require the components to be marked with the country of origin at the time of importation and would require the finished engine to be marked so as to disclose the origin of the components. This result would also be misleading in that a U.S. purchaser could be led to believe that the product was actually produced in Germany, when, in fact, a significant portion of its value was added in the U.S. operations.

Example 2 — Unfinished Goods

A company imports a rough forging into the United States for further processing into a finished wood chisel. The country of origin of the forging is Taiwan. Upon importation, Customs determines that the forging is a "blank" and classifies it in subheading 8205.30, HTSUS. The classification of blanks in the Harmonized Tariff is governed by GRI 2(a). As noted above, a blank is "an article, not ready for direct use, having the approximate shape or outline of the finished article or part, and which can only be used, other than in exceptional cases, for completion into the finished article or part." Pursuant to this rule, blanks are classified in the same heading as the finished article. Thus, the wood chisel blanks would be classified in HTSUS subheading 8205.30. The finished wood chisel would likewise be classified in HTSUS subheading 8205.30. The issue is whether the manufacturing operations in the United States result in a substantial transformation of the chisel blanks for purposes of the country of origin marking law (19 U.S.C. 1304). This determination would be governed by section 134.35 of the proposed rules of origin.

The tariff classification rules for subheading 8205.30 require a "change to subheading 8203.10 — 8207.90 from any other subheading including another subheading within that group." The forging obviously does not undergo the requisite tariff classification change and, therefore, does not become a good of the United States through the manufacturing operations in the United States. The origin of the forging would remain Taiwan. Thus, Customs would require the forging to be marked with the country of origin at the time of importation and would require the finished chisel to be marked so as to disclose the origin of the components. This result would also be misleading in that a U.S. purchaser could be led to believe that the

wood chisel was actually produced in Taiwan, when, in fact, a significant portion of its value was added in the U.S. operations.

We believe that the construction of the proposed rules of origin illustrated above is the result intended by Customs. However, other constructions of the proposed rules of origin potentially result in two different origin determinations. In this interpretation of the rules, which is applicable to both of the GRI 2(a) problems, the origin of the final product could not be determined through the change in tariff classification rules. The analysis would then proceed to section 102.11(b)(1) of the proposed regulations which states that "the country of origin of the good . . . [i]s the country or countries of origin of the single materials that imparts the essential character." If the analysis stops at this point, it would be necessary to determine whether the imported components or blanks provided the "essential character" to the finished good using the guidance provided by Section 102.18(b) of the proposed rules of origin. The definition of "essential character" in section 102.18(b) is vague and fails to satisfy Customs' self-imposed goal to "provide rules that are more objective and transparent and thereby to provide greater certainty and predictability for both the trade community and the Customs Service in making origin determinations . . . . " 59 Fed. Reg. 141 (Jan. 3. 1994). Instead, Customs would replace the existing subjective test for substantial transformation with another subjective test which would be more vague and difficult to administer. This situation would clearly result in protracted litigation as Customs and the importing community seek to define the meaning of the term.

The analysis of the GRI 2(a) situations using the liberal construction of the proposed rules of origin could also proceed beyond section 102.11(b). This would occur where the essential character is provided by the characteristics or functions added by the final processing rather than the materials incorporated therein. For example, if the essential character of a hand tool, such as the wood chisel in the above example, is not provided by its shape, but its ability to perform the function for which it is designed, then there is no material, as that term is defined in section 102.1(l), that fulfills the requirements of section 102.11(b)(1). Thus, since the country of origin cannot be determined under paragraphs (a) (b), or (c) of section 102.11, the analysis would proceed to paragraph (d). The first two subparagraphs of paragraph (d), dealing with "minor processing" and "simple assembly," do not apply. Consequently, the origin of the finished product would be the last country in which the good underwent production. Thus, the U.S. would be the country of origin and the imported components or blanks would be excepted from the country of origin marking requirements. This analysis results in an origin determination completely different from that discussed in the above examples. It is further evidence of failure of the proposed rules to address adequately the GRI 2(a) situations. Moreover, it demonstrates the ambiguity and lack of transparency in the origin rules where a tariff classification change does not occur.

b. The Good and Its Parts Problem

There are many headings and subheadings in the Harmonized Tariff System which provide for both the good and parts of the good. For example, Company A imports into the United States a forging for a ratchet handle. The forging would be processed in the United States by operations which include machining, cleaning, polishing, marking, heat treatment, vibratory polish, cleaning, muriatic acid bath, rinse, nickel plate, rinse, chrome plate, and rinse. The completed ratchet handle would be joined with other parts in the U.S. to form a useable ratchet. The added parts include: the inner body; pawl; reverser; pawl pin; spring; ball; and two retaining rings. At the time of importation, Customs determines that the forging is classifiable as a part of a ratchet and is classified in subheading 8204.20. The finished ratchet would also be classified in subheading 8204.20, which provides for "socket wrenches, with or without handles, drives and extensions, and parts thereof." The issue is whether the ratchet handle forging is excepted from the country of origin marking requirements.

The tariff classification change rules for subheading 8204.20 provide that "a change to subheading 8203.10-8207.90 from any other subheading, including another subheading within that group" results in a substantial transformation. Obviously, the ratchet handle forging cannot satisfy this requirement because it is classified in the same subheading as the article in which it is used. Thus, the ratchet handle forging would not become "a good of the United States" as provided in section 134.35. Consequently, Customs would require the forging to be marked with the country of origin upon importation and would also require the finished ratchet to be marked so as to disclose the origin of the components.

When presented with these exact facts in Headquarters Ruling Letter 733196 (Aug. 10, 1990), Customs ruled that the imported ratchet handle was substantially transformed by the U.S. processing operations and was excepted from the country of origin marking requirements. As has been shown, however, the proposed rules of origin mandate a different result. Nevertheless, Customs claims that the proposed rules of origin "codify the present country of origin rules . . . . " 59 Fed. Reg. 141 (Jan. 3, 1994).

Section 102.16 of the proposed rules of origin, as originally published by Customs in January 1994, dealt with the good and its parts problem in the following manner:

> (a) If a good is produced in one country but one or more of the foreign materials incorporated into the good do not undergo an applicable change in tariff classification provide in § 102.20 because:
>
> * * *
>
> (2) The heading for the good provides for both the good itself and its parts and is not further divided into subheadings, or the subheading for the good provides for both the good itself and its parts, the country of origin of a good is the country in which the good was produced provided that the production of the good results in a substantial transformation of those parts.

Customs stated that section 102.16 "proposes to allow country of origin determinations to be made on a case-by-case basis, as they are now." 59 Fed. Reg. 111 (Jan. 3, 1994). While this clearly is not an "objective and transparent" standard, it would have allowed a processor to present facts supporting a claim that its operations result in a substantial transformation of the imported parts.

Customs, however, removed section 102.16 from the proposed rules of origin in the amendments published at 60 Fed. Reg. 22312 (May 5, 1995). Customs supported this change by stating—

> The experience of Customs in administering the interim Nafta Marking Rules has shown that the hierarchical application of §§ 102.11 (b) through (d), coupled with the proposed change to § 102.11(d) discussed above, yield an appropriate result that codifies the substantial transformation principle. Accordingly, Customs no longer believes that § 102.16 is necessary.

The appropriate result, in Customs opinion, is that a substantial transformation can never occur for purposes of the country of origin marking law when an imported part fails the tariff classification change test because the tariff heading or subheading provides for both the good and its parts. This does not codify the current substantial transformation principle, and, in fact, significantly changes it by eliminating a wide range of manufacturing operations performed in the United States from the inquiry into whether a substantial transformation has occurred. Instead, the inquiry shifts to a vague and subjective determination of the material which imparts the essential character under Section 102.11(b).

The failure of the proposed rules of origin to provide a mechanism to determine whether a substantial transformation occurs in situations such as those illustrated above does not comport with the substantial transformation standard as it has been applied by U.S. Courts. This standard requires that:

> To determine whether a substantial transformation of an article occurred for purpose of ascertaining who is the "ultimate purchaser," each case must be decided on its own particular facts. *Grafton Spools, Ltd. v. United States*, 45 Cust. Ct. 16, 23, C.D. 2190 (1960). See also e.g., *United States v. Murray*, 621 F. 2d 1163 (1st Cir. 1980); *Texas Instruments, Inc. v. United States*, 69 CCPA __ (1982), 681 F.2d 778 (1982).

Uniroyal, Inc. v. United States, 3 CIT 220, 542 F. Supp. 1026 (1982). Despite this standard, Customs has apparently concluded that a substantial transformation can never occur with respect to the GRI 2(a) and the good and its parts problems discussed above. This conclusion is manifestly contrary to law for the reasons discussed in our submission to Customs attached as an appendix hereto.

As the proposed rules of origin will serve as the foundation of the position of the United States in the forthcoming negotiations to establish harmonized origin rules, Stanley requested origin opinions from its attorneys in Japan, the United Kingdom, Germany, France and Canada using the three scenarios outlined above. While the results of this informal survey

support the need for harmonization, none of the opinions received indicated that the existing rules of origin precluded a finding of substantial transformation based solely on a failure of a good to change tariff classifications due to the vagaries of the Harmonized System. If Customs and the Commission choose to advance this notion to the WCO, we suspect it will fail absolutely.

Stanley suggests that this situation can be remedied, and the U.S. negotiating position strengthened, by simply adopting the Nafta rules of origin as the basis for all origin determinations. This solution would eliminate the confusion resulting as importers wrestle with one set of rules for Nafta origin purposes and another set for Nafta marking purposes, as well as for all other origin determinations. It would also make U.S. companies more competitive in the international marketplace. Stanley's proposed solution would also address arbitrary determination imposed on the GRI 2(a) and the good and its parts situations by the proposed rules of origin. The Nafta rules, in Section 4(a) of the Interim Nafta regulations (19 C.F.R. Part 181, App. § 4), provide an exception to the change in tariff classification requirements. When any materials do not undergo a change in tariff classification because of GRI 2(a), the good may still qualify for the Nafta preferential duty rate if the "regional value content of the good . . . is not less than 60 percent where the transaction value method is used, or is not less than 50 percent where the net cost method is used . . . . " In other words, the good will qualify for preferential duty treatment if sufficient value is added in one or more of the Nafta countries. A similar exception is provided in section 4(b) for goods that do not satisfy the tariff classification change rules because the heading or subheading provides for both the good and its parts.

The value-added approach to the GRI 2(a) situation is also contemplated by Article 9(2)(c)(iii) of the Uruguay Round Agreement on Rules of Origin (ARO), which states:

> Upon completion of the work under subparagraph (ii) for each product or individual product category where the exclusive use of the HS nomenclature does not allow for the expression of substantial transformation, the Technical Committee:
>
> > shall consider and elaborate upon, on the basis of the criterion of substantial transformation, the use, in a supplementary or exclusive manner, of other requirements, including ad valorem percentages and/or manufacturing or processing operations, when developing rules of origin for particular products.

Thus, the negotiation of uniform rules of origin under the ARO will likely lead to the adoption of value-added standard (ad valorem percentage) in situations, such as the application of GRI 2(a), where a substantial transformation cannot occur by virtue of tariff classification change rules alone. The use of such value added criteria in determining origin in these cases would squarely address the problem instead of, as the proposed rules of origin do, simply state that no substantial transformation is possible regardless of the cost or complexity of the manufacturing operations performed in the United States.

In the event that a value-added approach is not feasible, Stanley proposes that the proposed rules of origin be modified to delineate the processing operations which would be sufficient to result in a substantial transformation. This solution, too, is contemplated by the ARO.

For the foregoing reasons, Stanley proposes that the Commission analyze the GRI 2(a) situation, as outlined above, and develop a minimum value-added standard or processing operations standard to determine whether a substantial transformation occurs when unfinished or unassembled goods, which fail the tariff classification change rules because they are classified as the finished or completed goods under GRI 2(a), undergo further processing operations in the country of importation. Stanley further proposes that similar standards be developed to determine whether a substantial transformation occurs when parts of a good, which fail the tariff classification change rules because the applicable heading or subheading provides for both the good and its parts, are used in further processing operations.

Stanley also proposes that the revised rules of origin be adopted for all U.S. laws which require an origin determination, such as the Generalized System of Preferences, Nafta, and false or deceptive advertising under the Federal Trade Commission rules.

Respectfully Submitted,
O'Donnell, Byrne & Williams

by:
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Attachment

Chairman CRANE. Thank you, Mr. Ayers. I guess you could crack nutshells with these two products you submitted to us, but I cannot think of any other meaningful utility.

Ms. Suarez.

STATEMENT OF EVELYN M. SUAREZ, CHAIRPERSON, RULES OF ORIGIN COMMITTEE, JOINT INDUSTRY GROUP

Ms. SUAREZ. Thank you. Mr. Chairman and members of the subcommittee, thank you on behalf of JIG, the Joint Industry Group, for this opportunity to testify on this important element of trade and customs administration. My name is Evelyn Suarez, and I am a partner with the law firm of Ross & Hardies. I am appearing here today as the chairperson for the Joint Industry Group's Rules of Origin Committee. Accompanying me is David Phelps, assistant vice president with the American Iron and Steel Institute.

The Joint Industry Group is a coalition of over 100 manufacturing companies, trade associations, and various other firms engaged in international trade and customs matters. Our coalition commends the chairman and the subcommittee for recognizing the significance that rules of origin have on the free flow of commerce and how such rules can operate as nontariff barriers. As both importers and exporters operating in a global environment, our members are directly and substantially affected by origin rules. Thus, the Joint Industry Group has had a historical interest in rules of origin and has consistently advocated origin based on objective standards that promote transparency, uniformity, predictability, and simplicity of application. As acknowledged by the chairman, origin rules that are inconsistent, arbitrary, and nontransparent operate as significant barriers to trade and investment.

The Joint Industry Group has supported the concept of internationally harmonized rules of origin under the GATT and now the World Trade Organization. Our group is especially pleased with the commencement of the WTO's 3-year work program and strongly supports the goals of the Uruguay Round Agreement on rules of origin. We plan to work with the administration and the U.S. International Trade Commission in developing a sound U.S. proposal. Consistent with the position advocated by our U.S. negotiators, it has and continues to be our position that rules of origin must rest on the longstanding principle of substantial transformation.

Our comments today are limited to nonpreferential rules of origin rather than those rules that act as standards for qualifying goods for preferential treatment. Nonpreferential rules are used in such contexts as collection of trade statistics, country of origin markings, most-favored-nation treatment and quotas. Satisfaction of nonpreferential origin rules is a prerequisite for cross-border trade.

In the nonpreferential context, many of our members, including those in the pharmaceutical, electronics, chemicals, hand tools, surgical instruments, and processed food sectors, have expressed concern over the substance of the NAFTA annex 311 rules and Treasury's proposal to expand these rules to all imported merchandise in the near term. At least one member is satisfied with the proposal for its sector.

Some of the problems expressed are: Treasury has rejected the use of the concept of substantial transformation occurring by a change in name, character, or use, in favor of the annex 311 rules; the proposal's use of essential components and simple assembly criteria; and finally, the rule contained in section 102.11(c) that a mixture or composite good to which no single material imparts the essential character is considered to have the countries of origin of all materials that "merit equal consideration for determining the essential character of the good." Thus, there may be multiple countries of origin.

Many of our members also find Treasury's timetable for implementing origin rules for all imported merchandise highly problematic. The timetable calls for expansion of the NAFTA annex 311 rules at a time when the U.S. Trade Representative has requested that USITC, the U.S. International Trade Commission, examine whether the Treasury rules do, indeed, conform to the substantial transformation test and should serve as a basis for the U.S. position in the WTO's origin harmonization work program. It is clear that for many of our members any new rules will cause companies to incur substantial costs as the result of changes to operating procedures designed to ensure compliance with origin requirements.

Treasury's implementation date does not represent good government because it is premature in light of the USITC investigation and the preliminary phase of the interagency process to develop the U.S. negotiating position in the international harmonization process. It is likely that for many sectors the U.S. Government will advocate rules different than those contained in Treasury's current proposal. The Joint Industry Group questions why the U.S. Government should proceed to implement new origin rules before a cohesive U.S. position is developed for those sectors. Moreover, a unilateral implementation of a new origin rules regime will require some of our manufacturing members to incur the enormous expense of modifying their operating practices only to remodify them when the WTO rules are ultimately adopted. Such modifications entail changes to origin tracking systems, as well as potential alterations to manufacturing processes and marking of goods.

Expanded implementation of the NAFTA 311 rules should proceed only for those sectors who are satisfied. For those sectors who have difficulties, at a minimum, implementation of the rules should await conclusion of the USITC investigation and final formulation of the U.S. position on origin rules in the WTO context. For the most part, however, Treasury should delay any proposal until conclusion of the WTO work program.

We note that at least one JIG member, the American Iron and Steel Institute, is highly supportive of both the timetable and the content of the proposed rules. The American Iron and Steel Institute believes that implementing the rules as soon as possible will put the U.S. Government in a much stronger negotiating position in the WTO work program. Finally, the American Iron and Steel Institute believes that implementation of the proposed rules is consistent with our obligations under the WTO rules of origin agreement that specifies that new rules can be promulgated if the process is open and transparent.

In sum, our membership generally has voiced serious concerns both about the substance and timing of the extension of the annex 311 rules. Thank you, Mr. Chairman, and members of the subcommittee. We will also be submitting a more detailed written submission for the record, and, of course, we would be pleased to respond to any questions.

Chairman CRANE. Thank you, Ms. Suarez.

Mr. McGrath.

STATEMENT OF MATTHEW T. McGRATH, COUNSEL, ON BEHALF OF PHARMACEUTICAL RESEARCH & MANUFACTURERS OF AMERICA

Mr. MCGRATH. Thank you, Mr. Chairman and members of the subcommittee. I am Matthew McGrath of the firm Barnes, Richardson & Colburn, and we are pleased to appear today on behalf of PhRMA, the Pharmaceutical Research & Manufacturers of America. We commend the subcommittee's interest and participation in the important process of harmonizing international rules of origin as well as the development and improvement of appropriate rules of origin applied for specific trade preferences. I will briefly summarize my testimony and will be pleased to answer questions.

The membership of PhRMA consists of virtually all research and development-based pharmaceutical manufacturers in the United States, as well as U.S. affiliates of similar manufacturers based abroad. All of these companies engage in international sourcing and manufacturing of pharmaceutical products and their precursors and are affected by any changes in the customs rules of not only the United States, but also the countries in which their components are sourced and where their finished products are sold. Rules which determine the origin of products must not only be appropriate for the products and processes common to the industry, but must be predictable and consistent from one country to the next.

The participants in the Uruguay round negotiations reached an agreement on the development of harmonized rules which will eventually offer this consistency and predictability. The World Customs Organization has undertaken a work plan to formulate a consensus on appropriate rules based on tariff classification changes and possibly other modifications.

At the same time, however, the U.S. Customs Service, as we heard earlier, has proposed to implement new tariff shift nonpreferential rules on a unilateral basis, which will subsequently constitute the initial U.S. position in the WCO process. These proposed rules were intended to reflect current practices and interpretations of the concept of substantial transformation as applied to specific products. In most cases, the proposed rules meet this goal. However, with respect to pharmaceutical products, the Customs proposal does not reflect current practice and could present the industry with inconsistent and costly regulatory requirements.

The Customs proposal concerning products classifiable in chapter 30 of the harmonized tariff schedule, pharmaceutical products, basically provides that a drug product will be deemed to originate in the country in which the constituent active ingredient was produced, regardless of the substantial amount of processing which is

undertaken to transform that active ingredient into a dosage pill which may be safely ingested. Under the proposal, the only way in which most drugs may be considered substantially transformed is by the addition of at least 40 percent by weight of local therapeutic or prophylactic content, a scenario which seldom occurs in the trade. This does not comport with the industry's understanding or past customs practice.

High potency pharmaceutical active ingredients are essentially unusable and even dangerous to a patient unless attenuated by excipients, binders, and other substances which are combined to form the finished product. Even after dilution, other dosage unit processing takes place such as lypholyzation, granulation, hydration, and drying, depending upon the intended final form and the delivery system. If I were to have samples here such as my colleagues, you would probably see a plastic container of a powder, which would constitute the bulk active ingredient, and then I would have a bottle of pills, which would be the finished product. Under the Customs proposal, transforming this bulk active ingredient into this bottle of pills is not a substantial transformation.

Since the pharmaceutical active ingredient is fundamentally different from a medicament, a change from one status to another should confer origin of the site where the change took place. Indeed, the Food and Drug Administration considers such processing to be a manufacture for labeling purposes. This is the position which will be taken by most other countries in the harmonization procedure. However, if the U.S. proposal is implemented prematurely and the opposing international position later prevails, the industry will be forced to change its labeling and perhaps other procedures twice in only a few years, and at great expense. Other unintended consequences of the change could include problems with foreign drug registration agencies, which authorize the marketing of products of a specific origin, or with foreign drug reimbursement qualifications, which are tied to a pharmaceutical's price in the country of origin. This would have an adverse effect on U.S. exports.

PhRMA believes that these problems are best avoided by awaiting the results of the multilateral harmonization process. While we support the goals of uniformity, predictability, and transparency, they should not be achieved through unnecessary disruption. The present case-by-case approach to determining origin, although sometimes less transparent, is at least the devil we know and, for the most part, reflects the industry's consensus on the issue of substantial transformation of drug products. If the United States deems it unnecessary or inappropriate to delay implementation, at the very least the proposed rules should be modified in the manner we have discussed in our statement and in our submissions to Customs.

Thank you very much, and I will be pleased to respond to questions.

[The prepared statement follows:]

STATEMENT OF MATTHEW T. MCGRATH, COUNSEL ON BEHALF OF PHARMACEUTICAL RESEARCH & MANUFACTURERS OF AMERICA

I am Matthew T. McGrath of the law firm Barnes, Richardson & Colburn, counsel to the Pharmaceutical Research and Manufacturers of America. We appreciate this opportunity to testify today before the Subcommittee concerning the development of internationally harmonized customs rules of origin, and the appropriate U.S. role in that process.

The membership of PhRMA consists of virtually all research and development-based pharmaceutical manufacturers in the United States, as well as U.S. affiliates of similar manufacturers based abroad. All of these companies engage in international sourcing and manufacture of pharmaceutical products and their precursors, and are affected by any changes in the customs rules of not only the United States, but also of the countries in which their components are sourced and their finished products are sold. Rules which determine the origin of products must not only be appropriate for the products and processes common to the industry, but must be predictable and consistent from one country to the next. We welcome this opportunity to comment on several aspects of the U.S. Customs Service proposals to implement, on a unilateral basis, certain changes in rules of origin applied to imported products.

PhRMA submits that, although international harmonization of these rules is a sound goal and represents an improvement over the existing case-by-case approach, efforts by the United States to implement tariff-shift-based rules unilaterally is not prudent, given the fact that the World Customs Organization is developing similar rules which will likely entail substantive differences requiring later changes by the United States. The laudable goal of transparency and predictability could well be undermined by the substantial burden on industry and commerce of adapting to new rules twice over a relatively brief period of time. Therefore we recommend that (1) the U.S. delay implementing any unilateral changes, pending completion of the WCO harmonization project, and that (2) the starting position for the U.S. proposal to the WCO, as reflected in the pending U.S. tariff-shift proposal for non-preferential trade, be modified to more accurately reflect the industry's understanding of substantial transformation in the pharmaceutical business.

On January 3, 1994, the U.S. Customs Service published companion Federal Register notices setting forth (1) rules for determining the country of origin of a good pursuant to Annex 311 of the North American Free Trade Agreement, and (2) proposed uniform rules governing the country of origin of all imported merchandise ("non-preferential" rules of origin). 59 Fed. Reg. 110 and 141. The latter apparently serve as the starting U.S. position for the international harmonization of Customs Rules of Origin, a work being undertaken by the World Customs Organization pursuant to the Agreement on Rules of Origin. On May 5, 1995, the Customs Service published proposed amendments to the proposed tariff-shift rules, inviting comment on only those proposed amendments. The May 5, 1995 changes, however, did not affect the original 1994 proposal as applied to pharmaceuticals.

The proposed rules are intended to codify existing practice in determining when a product is "wholly the growth, product or manufacture" of a country, or when it becomes a "new and different article of commerce" as a result of a manufacturing process in a given country which gives the article a "new name, character, and use which is different from that which existed prior to the processing." The latter determination is commonly referred to as the "substantial transformation" test whereby the country of origin of an article is determined to be the country in which the imported article assumed its final and distinctive identity prior to importation. This determination is a subjective one and has been generally determined by the United States Customs Service on a case-by-case basis.

In order to provide greater transparency in the origin determinations and provide "greater certainty and predictability

for both the trade community and the Customs Service," the Customs Service developed a list of rules whereby origin would be based upon tariff classification shifts for each HTSUS subheading which would, in most circumstances, equate to the results reached under the substantial transformation rule.

With respect to how this proposal deals with pharmaceutical products, two points are readily apparent:

(1) The proposed tariff shift rules applicable to pharmaceutical products and their intermediates do not, in some instances, reflect current practice; in other instances, they establish new concepts which fail to apply the concept of substantial transformation properly to pharmaceutical production and processing.

(2) In addition to the need to avoid international inconsistencies regarding customs rules of origin, any new U.S. rule of origin for pharmaceuticals should avoid diverging from generally-accepted international regulatory origin rules for product registration. This would not be the case if the proposed U.S. rules become generally applicable.

The Customs proposal concerning products classifiable under Chapter 30 of the HTSUS ("Pharmaceutical Products") basically provides that a pharmaceutical article will be deemed a product of the country in which it undergoes a process which results in a change in its tariff classification under the HTSUS, from any other subheading except one of the subheadings applicable to the bulk form of the drug in Chapter 30, or from a subheading applicable to the active ingredient in Chapter 29. With respect to HTSUS subheadings 3003.90 and 3004.90 -- basket categories which account for the vast majority of medicaments traded under Chapter 30 -- the product must undergo a change from any other subheading provided that the domestic content of the therapeutic or prophylactic components is no less than 40 percent by weight of total therapeutic or prophylactic content. This latter requirement is clearly not reflective of current or past practice by Customs. In fact, PhRMA believes that an origin determination based explicitly upon the relative weights of constituent components is both unprecedented and inappropriate. The domestic weight content requirement does not account for the fact that a true substantial transformation occurs in the formulation of many medicaments from active ingredients, regardless of whether any local therapeutic content is added. This will be discussed in further detail below.

In contrast to the proposed rules applicable to pharmaceuticals, the proposed tariff shift rules for chemicals carry the far more realistic proviso that any good "that is the product of a chemical reaction shall be considered to be a good of the country in which the reaction occurred," notwithstanding the apparent directive of any of the line-by-line tariff shift requirements.[1] If a chemical reaction takes place in the

[1] This provision is included in the Note to Section VI, and applies specifically to chapters 28, 29, 31, 32, or 38. It does not apply to Chapter 30, in which virtually all medicaments are classified, despite the fact that most products in Chapter 30 are made of products in Chapters 28, 29, 32, and 38. "Chemical reaction" is defined as a process in which chemical bonds in molecules are broken and new chemical bonds are formed between the fragmented molecules and/or added elements, so that one or more of the original bonds no longer link the same chemical elements or functional groups. In a reaction between two chemicals, neither need be a product of the country in which the reaction occurs for that situs to become the country of origin under this rule.

production of a medicament, however, such change does not, alone, result in a change in the country of origin.

The fact that the U.S. proposal does not reflect international consensus in the industry is critical. The Agreement on Rules of Origin provides for the establishment of a Committee on Rules of Origin within the World Trade Organization, and a Technical Committee on Rules of Origin under the auspices of the World Customs Organization ("WCO"). The Technical Committee is charged with the task of developing harmonized rules within three years of the entry into force of the Agreement, and the WCO has developed an internal organizational work plan for this purpose.

The work on harmonization is explicitly to be based on the principle that "rules of origin should provide for the country to be determined as the origin of a particular good to be either the country where the good has been wholly obtained or, where more than one country is concerned in the production of the good, the country where the last substantial transformation has been carried out." Art. 9(1)(b) (emphasis added). In addition, the Agreement provides that after the transition period, Members are to ensure that the principle of the last substantial transformation should apply, whether the basis for the rule is a tariff shift, an ad valorem percentage, a processing operation, or some combination of the three methods.

The proposal of the Customs Service to promulgate these new rules of origin for non-preferential trade at this time would be inappropriate for the following reasons:

(1) The GATT signatories have agreed to develop the harmonized rules through the technical assistance and mediation of the World Customs Organization. This was intended not only to coordinate the efforts of the member countries in an organized manner, but to avoid the imposition of inconsistent rules by member states during the period of development of harmonized rules. A unilateral step by the United States would preempt, if not undermine, that process. While the goal of the Treasury Department is clearly to reflect its current position on substantial transformation for the many products and processes which have been the subject of rulings in the past, there are undoubtedly many processes which are effectively ruled upon in the proposed rules as a matter of first impression, as is the case with some medicaments. Premature decisions on these matters will disrupt the WCO process and lead to inconsistent national rules, thus defeating the intent of the GATT signatories.

(2) The goal of harmonization is to achieve predictable, objective rules -- tariff shift requirements -- which express the international consensus on a subjective concept -- substantial transformation -- as applied to individual products. We submit that the proposal as published by the Customs Service does not reflect the international consensus view of substantial transformation as applied to pharmaceuticals. The unilateral imposition of these rules would, therefore, be contrary to the Agreement's proscription against regulations during the transition period which "create restrictive, distorting, or disruptive effects on trade."

The Customs proposal presumes that certain processes common to pharmaceutical production and formulation do not result in a substantial transformation, and therefore, do not result in a change of origin when certain processes are undertaken in more than one country. This perception is incorrect. The pharmaceutical industry internationally accepts that certain formulation processes are substantial, critical to the performance of a chemical product as a pharmaceutical, and definitely produce a new and different

article of commerce, with a new name, characteristics, and uses demonstrably different from those of the chemical intermediate or active ingredient.

High potency pharmaceutical active ingredients are unusable and even dangerous to a patient unless attenuated by excipients, binders and other substances which are combined to form the finished product. Even after such dilution, other dosage unit processing takes place such as lypholyzation, granulation, hydration, and drying, depending on the intended final form and delivery system. Since a pharmaceutical chemical ingredient is fundamentally different from a medicament, a change from one status to another should confer origin of the site where the change took place.

Specifically, a substantial transformation occurs when a pharmaceutical active ingredient classifiable under HTSUS Chapter 29 is combined with other chemicals, such as excipients, binders, and coatings which facilitate timed release of the therapeutic molecule into the body, to produce a medicament classifiable under HTSUS Chapter 30. In some of these formulation processes, a chemical reaction may occur between articles classifiable in Chapter 29, but the end result of the process is a new medicament classifiable in Chapter 30. Such a change is recognized by the pharmaceutical industry as the manufacture of a pharmaceutical product from constituent materials.

One example is that of a film coated tablet used in the treatment of gout. The finished product contains an active ingredient classifiable under Chapter 29, as well as 9 other ingredients classifiable in Chapter 29 and two ingredients classifiable in Chapter 32. Manufacture entails mixing, reaction, drying, grinding, lubrication, compressing, and film coating. During the reaction stage, the active ingredient is blended with a premix of the other ingredients under precise, specified conditions; a chemical reaction results between the active ingredient and one of the chemicals in the premix, and the molecular bonding imparts the therapeutic effect to the end product. The result is a bulk medicament classifiable in HTSUS 3003.90, which is them measured, compressed into tablet form, and coated to produce the final medicament classifiable under HTSUS 3004.90. This formulation process contributes as much as 50% to the value of the finished drug.

The formulation process described above would <u>not</u> result in a substantial transformation under the proposed Customs rules, despite the fact that a chemical reaction has taken place. Since 40% by weight of domestic therapeutic or prophylactic content was <u>not</u> added to the product in formulating a medicament classifiable under HTSUS 3003.90, Customs proposes to treat the drug as a product of the country in which the active ingredient was formulated, even though, in this case, that active ingredient cannot be "activated" without the molecular bonding with an additional element in the formulation of the finished medicament. Since the direct result of this formulation is a Chapter 30 medicament, rather than a Chapter 29 chemical, the chemical reaction headnote would be inapplicable and no substantial transformation will have taken place.

Another example is that of a medicament used to inhibit gastric acid secretion, distributed in finished dosage form as a capsule. Each capsule contains numerous pellets, each one of which contains specific quantities of the active ingredient and seven inactive ingredients. The release of the active ingredient in the intestine acts to inhibit the secretion of gastric acid, but in order for it to reach the intestine, it must pass through the stomach intact. In order to accomplish this, the core of each pellet, which contains the active ingredient, is treated with a subcoating and an enteric coating.

The core contains, in addition to the therapeutic active ingredient, seven other chemicals, all of which are classifiable in Chapter 29 of the HTSUS. Two of the ingredients are dissolved in water, agitated and cooled, while the remaining six ingredients are mixed and blended, then added at a specific rate to form a wet mix. The mix is extruded and dried under exacting conditions to form the pellets in a bulk compound medicament, classifiable under HTSUS 3003.90.

In the second stage, a subcoating solution which is designed to deter the release of the therapeutic ingredient is added to the pellets under very precise conditions. A third stage adds the enteric coating, also precisely formulated and performed on entirely different equipment. Both of the coating stages, in fact, may be undertaken in entirely separate facilities than that where the therapeutic core pellet is produced; they do not add any therapeutic content to the core, but are absolutely critical to manufacturing a pharmaceutical product which can deliver the active ingredient to the patient in a usable form. After these coating stages, the product is still classifiable in HTSUS 3003.90, but it has clearly undergone substantial processing.

The coated pellets are then formulated into dosages through size screening and measuring, and placement into capsules. The final stage processing results in production of an article classifiable under HTSUS 3004.90, a dosage form medicament. The entire process of combining the active ingredient with the several inert excipients, formulating and applying the subcoating and enteric coatings, and producing the dosage pharmaceutical adds substantially more than 50% to the finished value of the drug. The process has taken an active ingredient which is little more than a raw chemical, and converted it into a drug which may be ingested for therapeutic application.

Under the Customs proposal, if the active ingredient had been imported into the United States and all the operations described above had taken place in the U.S. facility, the product has not been substantially transformed, because the process did not add 40% by weight of therapeutic or prophylactic content. Even if there had been a chemical reaction in the formulation of the dosage, the end product would still be treated for customs purposes as an article of the country in which the active ingredient originated, since the chemical reaction headnote does not apply to Chapter 30.

Such a result is clearly contrary to the common understanding of the industry as to what constitutes substantial transformation. The end product has a new name, characteristic, and use, and is the result of difficult and expensive manufacturing processes -- perhaps even more expensive than those undertaken to produce the active ingredient. Customs has, in fact, ruled that the enteric coating operation alone is sufficient to create a new and different article which is more than an "alteration" for purposes of HTSUS 9802.[2]

These are only two of many pharmaceutical examples in which significant productive activities result in what should be a legally recognized "substantial transformation" under any tariff shift rules of origin. Regardless of whether a tariff shift rule is applied or an ad valorem criterion is used, these processes should result in substantial transformation of pharmaceutical articles. Few, if any, production processes for pharmaceuticals would result in the addition of 40% by weight of domestic therapeutic or prophylactic content, since the active ingredient is generally produced in a single location.

The foregoing examples deal only with the proposed origin rule as applied to drugs classifiable in HTSUS subheadings 3003 and

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[2] NY Seaport Ruling 854623 (Sep. 19, 1991).

3004. Other subheadings in Chapter 30 pose similar problems and, in the industry's view, impose unduly restrictive requirements for change in origin. For instance, an article classifiable in subheading 3004.40 (medicaments containing alkaloids or their derivatives) can be substantially transformed through a change from any other subheading except 1211 (plants and parts used for pharmaceutical purposes); 1302.11 (opium); 1302.19 (other vegetable saps and extracts); 1302.20 (pectic substances); 1302.39 (other mucilages and thickeners) 3003.40 (bulk medicaments containing alkaloids and derivatives) or any alkaloid or its derivatives provided for in chapter 29. In other words, the production of a finished dosage antihistamine from basic pseudoephedrine hydrochloride classifiable in HTSUS 2939.40.10, or any alkaloid-based finished dosage medicament from a natural alkaloid ingredient, would not result in a substantial transformation. These provisos in the Customs proposal effectively prevent any production of a medicament classified in HTSUS 3004.40 from any form of a basic alkaloid, from ever constituting a substantial transformation, regardless of the complexity of the operation, the amount of value added, or the importance of the formulation to the therapeutic application of the drug.

The Customs proposal in its present form disallows conferral of originating status on products resulting from many significant operations which the industry presently understands to change the name, character, and uses of drug products. Therefore, the tariff shift proposals concerning Chapter 30 should be amended to provide the following:

(1) The chemical reaction origin rule in the headnote to Section VI should be applicable to Chapter 30, as well as to the Chapters currently covered in the proposal;

(2) The line-by-line tariff shift rules for Chapter 30 should be revised to permit a change of origin for any change to a Chapter 30 subheading from any other subheading except the corresponding bulk mixtures subheading in Chapter 30.

(3) The line-by-line tariff shift rules should also be revised to eliminate any change of origin based on the addition of a specified percentage of domestic-origin content by weight (currently appearing in the proposal for subheadings 3003.90 and 3004.90);

(4) The rules applicable to Chapter 30 should also be amended -- either through additional line-by-line rules or the addition of a Section or Chapter headnote -- to provide that originating status may result from enumerated processes in pharmaceutical formulation which result in a tariff shift within Chapter 30, including a change from subheading 3003 to 3004. These processes may be limited to certain products, if appropriate, but should include those common to pharmaceutical formulation, as discussed above. Reasonable guidelines for the enumeration of such processes may be found in the Food and Drug Administration regulations on the definition of a "manufacturer" for purposes of product labelling. See 21 C.F.R. 201.1(b).

The Customs Service has recognized in the past the appropriateness of PhRMA's position regarding processes resulting in a change from Chapter 29 to Chapter 30. In HRL 554308 (1986), Customs ruled that the formulation of the finished dosage analgesic Naprosyn from the bulk active ingredient naproxen, and the formulation of the finished dosage analgesic Anaprox from the active ingredient naproxen sodium, are substantial transformations which rendered the dosage medicaments products of the country in which that formulation took place. This ruling predates the HTSUS, and the applicable provisions of the TSUS are not stated. However, the products and processes described likely would have represented

a change from TSUS Schedule 4, Part 1c to Schedule 4, Part 3c. Under the HTSUS, the processing described would clearly have represented a change from Chapter 29 to Subheading 3003, and should be treated as a substantial transformation in the Customs proposal.

Similarly, in HRL 555597 (1990), three imported bulk active ingredients -- norethindrone, ethinyl estradiol, and mestranol -- were combined in the U.S. customs territory with U.S.-origin excipients to formulate the finished dosage contraceptives Norethin and Demulen "which have new names, characters, and uses" which are different from the active ingredients. This process would represent a change from Chapter 29 (possibly heading 2937) to Subheading 3006, and is clearly a substantial transformation.

These rulings are merely illustrative of the current treatment of pharmaceutical processing by Customs, which is also confirmed by the result in NYR 854623 cited above with respect to the significance of the enteric coating process performed on capsules. Therefore, in order for Customs to meet its stated goal of ". . . codify[ing] the present country of origin rules in order to provide rules that are more objective and transparent," the revisions suggested above will be necessary.

If the proposed Customs origin rule for pharmaceuticals is adopted unilaterally by the United States, its inconsistency with other origin rules around the world would create numerous problems. Most importantly, pharmaceutical sales in most countries are authorized by health safety agencies, analogous to the U.S. Food and Drug Administration, through product registrations. Such registrations issued for drugs are limited to a specified origin; if the origin of a drug product is determined differently by the United States than by the country of registration, there will undoubtedly be confusion, delay, and possibly denial of entry for such products in the country of registration. For instance, if a country treats an approved drug as originating in the United States because the formulation of the dosage medicament takes place there, it is uncertain how that country will treat the product after the U.S. Customs Service declares that it is no longer produced in the United States, but in the country where an active ingredient underwent its last chemical change. Some countries' drug regulatory agencies will defer to the U.S. determination of origin, in which case, the certified origin of the active ingredient may not be an approved country for product registration purposes.

To the extent that other countries apply the concept of substantial transformation we have outlined above, i.e., conversion from a Chapter 29 to a Chapter 30 article, a drug product under the Customs proposal would have dual origins. This problem cannot await conclusion of the WCO harmonization to be resolved, and therefore, should be avoided through deferral of the unilateral change.

Conclusion

PhRMA submits that any unilateral promulgation of new non-preferential rules of origin by the United States, regardless of whether they truly reflect current customs practice (which, PhRMA believes, they do not), would be premature. The GATT Uruguay Round signatories have agreed to develop harmonized rules of origin; the implementation of Customs' proposal, whether or not it is modified as we have suggested above, would preempt that effort, creating trade disruption and commercial hardship when the results of the GATT harmonization require further changes in U.S. practice at a later time.

To the extent Customs does apply new rules of origin to non-preferential trade, the tariff shift rules contained in the January 3, 1994 proposal fail to reflect current U.S. or foreign practice, or take into account real changes in the production processes for pharmaceuticals which result in a new name, characteristic, or use. PhRMA urges, at a minimum, that Customs adopt the suggested modifications set forth herein, so that the rules will both reflect the real and complex changes which occur in pharmaceutical formulation, and remain consistent, in tariff and regulatory law, with what the rest of the world considers "substantial transformation" in the pharmaceutical industry.

Chairman CRANE. Thank you, Mr. McGrath.
Mr. McCarthy.

STATEMENT OF JAMES P. McCARTHY, CHAIRMAN, STANDARDS REGULATIONS COMMITTEE, NATIONAL COFFEE ASSOCIATION OF USA, INC., NEW YORK, N.Y.

Mr. MCCARTHY. Please feel free to examine, open, and smell the samples that are being distributed to you.

Good afternoon, and thank you for the opportunity to testify today.

Chairman CRANE. Before you testify, Mr. McCarthy, may we take these in the backroom and put them in the coffee pot?

Mr. MCCARTHY. If you would like. [Laughter.]

Chairman CRANE. Thank you.

Mr. MCCARTHY. My name is James McCarthy, and today I am representing NCA, the National Coffee Association of USA, Inc., based in New York City. The NCA is the trade association of coffee importers and manufacturers who represent approximately 90 percent of the coffee sold in the United States. I currently serve as chairman of NCA's Standards Regulations Committee. I am employed at Procter & Gamble and have been involved in their coffee business for the past 10 years.

We are here today to seek relief from proposed rule of origin labeling requirements which would be of no benefit to consumers and costly to our industry. As noted in the subcommittee's press release, the Treasury Department has proposed rules of origin for both NAFTA and general use which would base substantial transformation decisions on changes in tariff classifications. Under the proposed rules, all coffee beans which are imported, roasted, and ground in the United States would be considered to be substantially transformed, and therefore would not have to be labeled with the origin of various beans. The NCA strongly supports this position and appreciates the assistance we have received from Treasury in this regard.

The Treasury proposal would, however, treat instant coffee differently. Under the proposal, retail jars of instant coffee would have to be labeled with the origin of the manufactured soluble powder. In response to the Treasury Department's request for comments on the proposed regulations, NCA filed comments objecting to the labeling requirements for soluble coffee. We stated in those comments and continue to believe that soluble powder is substantially transformed during processing, and therefore retail instant coffee should not have to bear country of origin labeling.

Treasury has indicated, however, that they do not agree that necessary processing constitutes substantial transformation and suggested to us that we seek a legislative solution to our predicament. In response, NCA has drafted language to exempt soluble coffee from the proposed requirement.

The language would also confirm the current status of roasted and ground coffee. In order to make a consumer acceptable instant coffee product, soluble powder is subjected to extensive processing requiring technical sophistication, major manufacturing equipment, and imparting significantly improved performance characteristics. During processing, imported soluble powder is transformed from a

fine light brown powder to larger dark brown granules with a coffee-like appearance characteristic of retail instant coffee.

Retail instant coffee dissolves readily, providing the convenience sought by consumers, unlike soluble powder, which literature indicates can take up to 20 to 40 seconds to dissolve. Retail instant coffee is not subject to dusting and does not clump, form scum, or foam on the beverage drink preparation as does the soluble powder. In addition, aromas and essences are added during processing to impart a characteristic coffee aroma, as opposed to the faint odor of imported soluble powder.

The transformation of imported soluble powder to the retail instant coffee product involves several steps. Imported soluble powders are blended to deliver the taste expected for a particular manufacturer's product. After the blending operation, the powder is subjected to a mill which produces particles of the appropriate size to be agglomerated.

This milled powder is then contacted with steam in an agglomerator in which particles coalesce to form larger darker agglomerates. These agglomerates are then dried to remove excess moisture, and screened to provide material of appropriate size to the finished product. The sized agglomerates are then filled into jars for retail sale, and aromas or essences are added to produce a coffee-like aroma expected by consumers.

The packages are then filled with inert gas to reduce the potential that the product will become stale. Finally, packages are sealed and palletized for shipment. The process involves significant technical sophistication with about 90 patents being issued worldwide for agglomeration alone. Required equipment is typically housed in a building estimated approximately 40 feet wide by 150 feet long and two stories high. Cost of construction is approximately $5 million.

Manufacturers certainly would not go through this trouble or expense, if this processing did not transform imported soluble powder into a product that was significantly different in taste, appearance, aroma, and dissolving properties.

If we are forced to implement the rules as proposed, the consumer would derive no benefit from the information, but ultimately would bear the burden of industry's increased costs. Manufactured soluble coffee powder currently is imported from 24 countries, ranging from Brazil and Colombia to Japan and Switzerland. Depending on taste profiles, availability, and price, each producer purchases, mixes, and processes totes of powder weighing as much as a thousand pounds from one or more of these sources to produce a commercially acceptable retail product. Thus, the sources may change regularly.

Under the proposed rules, we are faced with two unfortunate choices. First, we could add a small amount of powder from each of the 24 countries and affix a label listing these countries. This approach obviously provides no useful information to the consumer. Second, we could constantly change our labels to reflect the actual source of imported powder in each batch of products. This approach would result in a one-time charge as high as $13 million and estimated ongoing annual costs of $7.5 million. Ultimately, those costs would be borne by consumers.

Finally, consumers know that none of the limited supply of beans grown in the United States are made into instant coffee, and frankly do not care where the beans are made into powder. Therefore, our proposal would not harm consumers or threaten any U.S. interests. Finally, our proposal is revenue neutral.

We are grateful for the opportunity to testify and we look forward to working with the subcommittee and the administration on a solution.

Thank you very much.

[The prepared statement follows:]

RULES OF ORIGIN

Testimony of
James P. McCarthy
Chairman, Standards Regulations Committee
National Coffee Association of USA, Inc.

Before
The U.S. House of Representatives
Ways and Means Committee
Trade Subcommittee
July 11, 1995

Good afternoon, and thank you for the opportunity to testify at this important hearing on rules of origin.

My names is James McCarthy, and today I am representing the National Coffee Association of USA, Inc., based in New York City. NCA is a trade association of coffee importers and manufacturers whose combined commerce in coffee represents approximately 90% of the coffee sold in the United States. I currently serve as chairman of the NCA's Standards Regulations Committee. I hold a Ph.D. in Chemistry from the University of Cincinnati. I am currently employed at the Procter & Gamble Company and have been involved in their coffee business for about the past ten years.

We are here today to inform you concerning the issue of country of origin labeling which is of great significance to the coffee industry. On January 3, 1994, the U.S. Customs proposed rules (59 Fed. Reg. 110 and 141, and as amended on May 5, 1995, 60 Fed. Reg. 22312) which will cause retail instant coffee products made from imported soluble coffee powder to carry country of origin labeling. Prior to this proposal, the industry operated on the basis that instant coffee manufactured from imported soluble powder was a product of the United States because of the substantial transformation which occurs prior to retail sale.

NCA filed comments in the Customs proceeding disagreeing with the Customs proposal which would compel the conclusion that imported soluble powder is not substantially transformed during processing to retail instant coffee products. We have now learned from Customs and the Department of the Treasury that the rules will be finalized as written for instant coffee. Nonetheless, because of the unique situation faced by coffee industry, Customs and the Department of the Treasury have indicated that they would not oppose a legislative solution. We therefore urge the Congress to adopt legislation to provide the needed safe harbor from the expected new rules for instant coffee products.

We firmly believe that imported bulk soluble powder is substantially transformed in the production of retail instant coffee and thus should not be required to carry country of origin labeling. Today, I wish to present information to support two points: 1) substantial transformation does occur in the production of instant coffee; and 2) complying with country of origin labeling provides no meaningful consumer benefit while creating substantial cost and administrative burden for the industry.

Soluble Coffee Powder is Substantially Transformed

Soluble coffee powder is manufactured both inside and outside of the United States. To produce soluble coffee powder, green coffee beans are roasted and ground, then subjected to multiple extractions with hot water. This extract is concentrated and spray dried resulting in a product which can be reconstituted with hot water. Soluble powder can be purchased from up to 24 countries outside of the United States.

While soluble powder can be reconstituted to a coffee beverage, it is unacceptable today to the consumer for four reasons: 1) soluble powder is subject to dusting when handled, creating messiness for the consumer during preparation; 2) soluble powder dissolves slowly (literature estimates up to 20-40 seconds[1]); 3) soluble powder forms clumps on dissolution (as would be expected from the wetting of any fine powder) as well as producing scum and foam on the surface of the beverage; and 4) soluble powder possesses a weak, non-coffee like aroma.

In order to make a consumer acceptable instant coffee product, soluble powder is subjected to extensive processing requiring technical sophistication, major manufacturing equipment and imparting significantly improved performance characteristics. During processing, imported soluble powder is transformed from a fine light brown powder to the larger dark brown granules with coffee like appearance characteristic of retail instant coffee products. Retail instant coffee products readily dissolve, providing the convenience sought by consumers. Retail instant coffee products are not subject to dusting and do not clump or form scum or foam on the beverage during preparation. In addition, aromas and essences are added during processing to impart a characteristic coffee aroma as opposed to the faint odor of imported soluble coffee powder.

The transformation of imported soluble coffee powder to the retail instant coffee product involves several steps. As they enter the instant coffee process, imported soluble powders are blended with other soluble powders to deliver the taste expected for a particular manufacturer's product. After the blending operation, the powder is subjected to a mill which produces particles of the appropriate size to be agglomerated. This milled powder is then contacted with steam in an agglomerator where the particles coalesce to form larger darker agglomerates similar to those in the retail coffee product. These agglomerates are then dried to remove the excess moisture of agglomeration and screened to provide material of appropriate size for the finished product. The sized agglomerates are then filled into jars for retail sale and aromas and essences are added to produce a coffee-like aroma expected by consumers. The packages are then typically purged with an inert gas to reduce the potential to become stale, and sealed and palletized for shipment.

The process involves significant technical sophistication with 92 patents being issued worldwide for agglomeration alone. The required equipment is typically housed in a building estimated at approximately 40 feet wide by 150 feet long and 2 stores high. The facility could be constructed at a cost of approximately $5,000,000. Manufacturers certainly would not go through this trouble or expense if this processing did not transform imported soluble powder into a product with significantly different appearance, taste, aroma and dissolving properties.

No Meaningful Consumer Benefit for Industry Burden and Added Costs

Finalization of Customs proposed rules would cause a loss of manufacturing flexibility and impose a significant burden on the coffee industry. If manufacturers chose to buy spot-market soluble powder, they would be forced to constantly change labels to reflect the country of origin of the powders used in a particular production lot. Alternatively, manufacturers could choose to consistently source their powders from the same countries and incur additional costs from the inability to take advantage of spot market prices. This approach could also degrade the consistency of the product since manufacturers would have fewer alternatives to meet the needs of their particular blend. Either of these approaches impose an additional cost to the industry.

An alternative means of compliance would be to maintain a blend of imported soluble powder from all possible producing countries and add a nominal amount of this powder to every production lot while maintaining labeling which declared all originating countries as countries of origin. Such an approach provides no meaningful information, creates additional costs and consumes label space on a very small package.

We have identified no parties adversely affected by not carrying country of origin labeling on coffee packages. It is commonly known by consumers in the United States that coffee is imported from outside of this country. Further, countries such as Cuba, which grow coffee but do not have

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[1]M. Sivetz & N.W. Desrosier, Coffee Chemistry; AVI Publishing Co., Westport, CT (1979) p. 425

trade relations with the US, are prohibited from inclusion by force of law. Thus, there is no consumer deception nor is there any significant information provided to consumers which they do not already have.

In order to comply with Customs rules and give consumers this trivial information, the industry would face higher costs. Specifically, the initial one-time costs of introducing country of origin labeling to retail instant coffee products has been estimated at between $3,000,000 - $13,0000,000[2]. The annual ongoing costs assuming quarterly redesign of labels and that at least one source country for imported soluble powder was changed quarterly, is estimated at over $7,500,000 per year.

In addition to the effects outlined above, finalization of the rules could also produce international repercussions. Many of the countries which produce soluble coffee powder are small countries with loans and debt obligations to the United States, or countries which carry favored-nation status. If flexibility is reduced because of these regulations, these countries could be negatively impacted since manufacturers would be less prone to take advantage of all sources of material available to them.

Legislation exempting coffee products from country of origin labeling requirements is not opposed by Customs or the Department of Treasury and will avoid the unnecessary costs and issues previously mentioned without any detrimental effect on consumers.

Thank you for your attention and consideration of this request.

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[2]Industry Survey Data

Chairman CRANE. Thank you very much

Mr. McGrath, how do the interim rules that are proposed differ from those rules used by other countries in the production of pharmaceutical products?

Mr. MCGRATH. Well, a number of the other countries where U.S. pharmaceutical manufacturers sell their products or from whom they might source some raw materials apply rules of origin that are based on a substantial transformation principle which is applied in a very similar fashion to the way Customs has been applying it here. A transformation, a processing of an active ingredient of raw material which is usually a powder chemical into a dosage form pill or medicament, is treated as a substantial transformation, for instance, by the European community for products imported into the European community.

At this time as part of their input into this WCO process, the European community is considering a rule which would permit substantial transformation to take place by virtue of a tariff shift from chapter 29, which is where most raw chemicals are classified, into chapter 30, which is where the finished drug medicaments are classified. They are also considering other approaches. But the approach applied by at least the European community, which is one of the largest markets outside of the United States, we feel is probably a more accurate approach.

Chairman CRANE. Thank you.

Mr. McCarthy, Customs contends that, based on rules dating back to 1986, agglomerated coffee has been required to be marked to identify all individual sources. How does your association respond to Customs position?

Mr. MCCARTHY. I am not aware of a Customs ruling on the issue right now. The industry has generally relied on the advice of their counsel's interpretation of the Customs marking rules.

Chairman CRANE. I see.

Mr. Rangel.

Mr. RANGEL. Do any of you know of any country that has been able to deal with the question of rules of origin or marking requirement that are much less complex than the ones that we use? If so, what country? All countries have faced the same type of problem as we do? Do our exporters complain that they have the same problems that those who import have?

Mr. MCGRATH. If I could just answer, in many cases I am aware of clients in various industries, they may be shipping products to countries where the determination of origin may be just as difficult to reach as it has been here on a case-by-case basis, but where that particular country may not have a marking requirement or no requirement that they have to place country of origin on the label.

In most instances, I am not aware of many major developed market countries around the world that have imposed a very technical tariff shift type of a rule. I know that all the countries at the WTO agreed to look into this as the basis for a harmonized rule of origin.

So I would agree with Mr. Simpson's testimony earlier that we are all in favor of uniformity, predictability, and transparency. Where we disagree is, I think all of us here probably disagree with the statement from the administration that if these new rules were imposed on a unilateral basis, the results would be exactly the

same tomorrow as if the decision were made on a case-by-case basis. We disagree and that is why we are here.

Mr. RANGEL. Most all of your disagreement is with Customs and the rules that we are setting here, which makes it difficult for you in terms of marking and a variety of other costly things. What you are saying, Mr. McGrath, is that to your knowledge you do not know of any problems that our exporters face by exporting to countries that have similar complexities in determining the origin and the marking. You are saying that it is the importing that is the problem, not the other countries.

Mr. MCGRATH. Well, with respect to the pharmaceutical industry, I am not aware of any problems. Where the concerns have been expressed by the industry is with problems that could be faced in shipping to those other countries if, for instance, the drug regulatory agencies of those countries would defer to a U.S. ruling that a product that used to be made in the United States is now made elsewhere.

Mr. RANGEL. Why does it take the WTO to harmonize, if we are the only problem?

Mr. AYERS. Maybe I will take a stab at it. Our unscientific survey of some of the foreign markets where we do business indicates that some combination of substantial transformation or value added seems to be the concepts on which they are basing country of origin markings, and that seems to be fairly consistent around the world. We seem to be the ones getting out of step with that.

So if your question is how would the harmonization tend to trend, I think maybe the rest of the world is suggesting that something along those lines is perhaps where the world ought to be, and I think that is where we probably ought to head.

Mr. RANGEL. Are your agencies, department and trade organizations, advocating that we take a look and encourage Customs and WTO to do this? Because Mr. Simpson said that this was too complex even for him to render an opinion.

Mr. AYERS. I hope that they are going to take the discussion seriously and try to develop a harmonized scheme around the world. The dilemma that we have on those nice simple wrenches that I shared with the subcommittee, those do not represent a tariff shift and so——cannot be marked "Made in the U.S.A." even though the majority of value is added here.

Mr. RANGEL. Also I agree, Mr. Ayers, that harmonization would be the United States trying to get in line with other countries.

Ms. SUAREZ. The WTO program initiates a work program to harmonize origin rules. Therefore, we are at the beginning stages. Our point is that it is premature at this time to extend the annex 311 rules for all imported merchandise when the U.S. Government has not finally established its position. As I pointed out, the USTR had asked ITC to use the Treasury proposal as a baseline and to go forward to develop that position. Therefore, we are at the very beginning stages, and it would be unfair to companies to adopt rules now, to adopt rules later at the conclusion of the ITC study and then ultimately at the conclusion of the WTO work program.

You do make a very good point, Congressman Rangel, that this will have an impact not only on imports, but exports, as well, with the harmonization process.

Mr. RANGEL. Thank you, Ms. Suarez.

Chairman CRANE. Mr. Neal, do you have any questions?

Mr. NEAL. Just a quick question, Mr. Chairman. I know we have to run and vote.

Mr. McCarthy, why is the price of coffee so high? Do not blame it on any foreign competition, either.

Mr. MCCARTHY. Why is it so high?

Mr. NEAL. Yes.

Mr. MCCARTHY. Well, there was a frost in Brazil, that was the initial reason for it. Why the price is exactly where it is today, I would not pretend to know. I do not do commodities myself.

Mr. NEAL. But you agree that the price is high, though?

Mr. MCCARTHY. It is all relative.

Mr. NEAL. This is your chance to promote name recognition for yourself inside the company. [Laughter.]

Chairman CRANE. Let me thank all the witnesses who testified here before the subcommittee today. I think we are down to about 3 to 4 minutes, so we will stand in recess before the next group appears before our subcommittee, and that panel is Ms. Guarino, Mr. Folkerts, Mr. Stanceu, and Ms. Kline.

We will be back in just a few minutes.

[Recess.]

Chairman CRANE. If everybody will please take seats, we will reconvene.

Our first witness is Ms. Guarino.

STATEMENT OF ELIZABETH TONI GUARINO, VICE PRESIDENT AND GENERAL COUNSEL, GROCERY MANUFACTURERS OF AMERICA, INC.

Ms. GUARINO. Thank you, Mr. Chairman.

I am Toni Guarino, vice president and general counsel of GMA, the Grocery Manufacturers of America. GMA is an organization led by the chief executive officers of the Fortune 500 companies that make the world's best known brands of food and other consumer packaged goods, 85 percent of such products that are sold in the United States.

Thank you for the opportunity to address these issues which are important to many of our members. GMA's members are affected by rules of origin in two significant ways. As importers of ingredients, they are affected by regulatory issues under U.S. tariff laws, including regulations pertaining to country of origin markings. As exporters, they are affected by rules of origin of foreign countries. Because they are both importers and exporters, our members do favor development of internationally harmonized rules of origin that are neutral and do not impose barriers to the sale of U.S. goods in foreign markets.

Turning to the specific issues and reflecting earlier industry views, GMA believes the Treasury Department should defer any further action to develop nonpreferential rules of origin pending completion of the WTO work program. As noted earlier, Treasury currently applies its interim nonpreferential rules of origin, which I will refer to as the part 102 rules, to products traded among the NAFTA parties, and Customs has proposed to extend these rules

beyond NAFTA and apply them to all products in international trade. This would be premature and unwise.

First, the part 102 rules have met with considerable criticism in the business community. Some critics have pointed out, and GMA agrees, that they do not in all cases adhere to the longstanding principles of substantial transformation that have been applied for decades by the courts. So rather than extending the part 102 rules, GMA believes Customs should modify them and bring them into conformity with established principles of substantial transformation as soon as possible. Even more important, Treasury should ensure that U.S. companies involved in international trade are not needlessly burdened by successive changes in origin rules.

For these reasons, the rules as applied to products generally should not be finalized until completion of the WTO work program. Until that time, Treasury should concentrate on correcting the existing deficiencies in the rules as they apply in the NAFTA context.

In contributing to the development of the WTO rules, and in administering its own rules of origin, we believe the United States should adhere to three principles: First, in conformity with the WTO Agreement, the United States should administer its rules of origin to facilitate and not create unnecessary obstacles to the flow of international trade. Second, Treasury should stop applying the country of origin marking requirement as a trade-restricting instrument of its trade policy.

Third, in interpreting and applying rules of origin and country of origin marking requirements, Treasury should be guided by the principle that an agency should regulate only when necessary and only to the extent necessary to effectuate the intent of Congress. Treasury and Customs have not consistently adhered to these principles. Instead, they have interpreted country of origin rules, and in particular the country of origin marking rules, to create unwarranted burdens on U.S. manufacturers, including some of our members.

Let me give two examples very briefly, and I believe some of the other witnesses on this panel will expand on them. First, in December 1993, Customs ruled that packages of imported frozen produce are not properly marked unless the country of origin appears on the front panel of the package. The ruling also specified minimum type size, type style, and spacing requirements that could not be implemented in any practical sense. This decision was invalidated by the Court of International Trade, but the issue is still undecided. The Customs Service is currently conducting a rulemaking on whether special regulations for the marking of imported frozen produce are necessary.

The second example deals with frozen vegetable mixtures made in the United States from imported ingredients. The nonpreferential rules of origin currently are applied to NAFTA products. In those rules Customs has incorporated a rule under which certain frozen mixed vegetable products are determined to have multiple countries of origin corresponding to the countries of origin of the various ingredients. The rule applies where no single foreign ingredient imparts its essential character to the finished product.

This rule is inconsistent with section 304 of the Tariff Act of 1930, which requires that a foreign article be marked to indicate to the ultimate purchaser the country of origin of the article itself, but does not require marking of the foreign ingredients used in producing the article. Again, under longstanding principles of substantial transformation, a foreign good is considered to be substantially transformed when it is blended as an ingredient with other goods and does not impart an essential character to the finished good.

In both of these examples, Treasury and Customs have adopted legally questionable interpretations of the marking requirement. In both cases, the action by Treasury and Customs was taken following pressure from domestic protectionist interests. GMA believes these two examples are illustrative of actions that are inconsistent with U.S. obligations under the WTO Agreement on rules of origin.

That concludes my remarks, Mr. Chairman. Thank you again for the opportunity to address these issues.

[The prepared statement follows:]

**TESTIMONY OF ELIZABETH TONI GUARINO,
VICE PRESIDENT, GENERAL COUNSEL,
GROCERY MANUFACTURERS OF AMERICA, INC.,
BEFORE THE HOUSE SUBCOMMITTEE ON TRADE,
COMMITTEE ON WAYS AND MEANS,
ON THE SUBJECT OF RULES OF ORIGIN**

July 11, 1995

On behalf of the Grocery Manufacturers of America, Inc. ("GMA"), I appreciate the opportunity to testify before this Committee on the subject of rules of origin. GMA is an organization led by the CEOs of Fortune 500 companies that make and market the world's best-known brands of food and consumer packaged goods. GMA is the industry voice on public policy and industry productivity issues, through strategic issues management involving government relations, communications, legal, regulatory, scientific and education advocacy. GMA member company sales, totaling $360 billion, represent the largest volume (85 percent) of all food and consumer packaged goods sold in the U.S.

GMA's members are affected by rules of origin in two significant ways. As importers of ingredients for use in manufacturing grocery products, they are affected by regulatory compliance issues under U.S. tariff laws, including the laws and regulations pertaining to country-of-origin marking. As exporters, GMA members are affected by country-of-origin rules and marking rules of foreign countries. Accordingly, GMA's members are in favor of the development of internationally-harmonized origin rules that are neutral and transparent and that do not pose barriers to the sale of their goods in foreign markets.

GMA appreciates the Committee's interest in rule of origin issues and in the work program to develop internationally-harmonized origin rules through the World Trade Organization ("WTO"). GMA is pleased to accept the Committee's invitation to provide its views on the current administration of rules of origin by the U.S. Treasury Department.

I. THE TREASURY DEPARTMENT SHOULD DEFER ANY FURTHER ACTION TO DEVELOP NON-PREFERENTIAL RULES OF ORIGIN PENDING COMPLETION OF THE WTO WORK PROGRAM

The Treasury Department currently applies its recently-developed, interim non-preferential rules of origin to products traded among the NAFTA parties. These rules are codified as Part 102 of Title 19, Code of Federal Regulations ("Part 102 rules"). As this Committee has noted, the Customs Service has proposed to extend the Part 102 rules beyond the NAFTA context and apply them as non-preferential rules for all products in international trade. GMA believes that such a step would be premature and unwise.

As this Committee is aware, the Part 102 rules have been the subject of considerable criticism in the business community. Some critics have pointed out, and GMA agrees, that the Part 102 rules do not in all cases adhere to the long-standing principles of substantial transformation that have been formulated by the courts over the last half-century.

GMA believes that the Part 102 rules should be brought into conformity with established principles of substantial transformation as soon as possible. Even more important, the Treasury Department should ensure that U.S. companies involved in international trade are not needlessly burdened by successive changes in origin rules. GMA sees no justification for the establishment of new, temporary rules of origin that will impose additional regulatory burdens on

affected parties, particularly the need to change labels on food products to comply with the marking requirement.

For these reasons, the Part 102 rules, as applied to products generally, should not be finalized until the completion of the WTO program for the international harmonization of rules of origin. Until that time, Treasury and Customs should impose no new regulatory burdens by changing the rules of origin, and instead should concentrate on correcting the existing deficiencies in the Part 102 rules as they apply in the NAFTA context. In this regard, Customs should not administer the Part 102 rules in such a way that affected parties are required to adhere to marking requirements more burdensome than those that would apply if the traditional substantial transformation principle were followed.

II. THE U.S. SHOULD ADHERE TO THE PRINCIPLES OF THE WTO AGREEMENT ON RULES OF ORIGIN AND SOUND REGULATORY PRACTICE

GMA believes the development of transparent, internationally-harmonized rules of origin will facilitate international commerce and provide a higher level of predictability for international commercial transactions. In contributing to the development of these rules, and in administering its own rules of origin, the U.S. should adhere to the following principles:

1. In conformity with the WTO Agreement on Rules of Origin, the U.S. should administer its rules of origin to facilitate, and not create unnecessary obstacles to, the flow of trade. The U.S. should apply its origin rules in a neutral manner and should not use its origin rules as instruments to pursue trade objectives or to create restrictive, distorting, or disruptive effects on trade;

2. In particular, the Treasury Department should stop applying the country-of-origin marking requirement as a trade-restricting instrument of its trade policy, adhering instead to the principles of the Agreement on Rules of Origin mentioned above; and

3. In interpreting and applying origin rules and country-of-origin marking requirements, the Treasury Department should be guided by the principle that an agency should regulate only when necessary, and only to the extent necessary, to effectuate the intent of Congress.

The Treasury Department and its bureau, the Customs Service, have not consistently adhered to these principles. Instead, Treasury and Customs on some occasions have interpreted country of origin rules, and in particular the country of origin marking rules, so stringently as to create unwarranted burdens on affected U.S. manufacturers, including some of GMA's member companies. Some illustrative examples are discussed below.

1. Front-Panel Marking of Frozen Produce Products

In Treasury Decision 94-5, issued December 29, 1993, the Customs Service ruled that packages of imported frozen produce are not properly marked unless the country of origin marking appears on the front panel of the package. The decision also specified onerous minimum type size and spacing requirements for the marking, even prescribing specific type styles and upper-case lettering.

T.D. 94-5 was invalidated by the Court of International Trade, which ruled that the decision was not promulgated in accordance with the requirements of the Administrative Procedure Act and Section 304 of the Tariff Act of 1930, as amended. 1/ The issue whether to impose the special marking requirements on packages of imported frozen produce remains undecided: Earlier this year, the Customs Service issued an advance notice of proposed rulemaking requesting public comment on whether special regulations for the marking of frozen produce are necessary. 2/

2. Frozen Vegetable Mixtures Made in the U.S. from Imported Ingredients

In the non-preferential rules of origin that Customs currently applies to NAFTA products, Customs has incorporated a rule under which certain frozen mixed vegetable products are determined to have multiple countries of origin corresponding to the countries of origin of the various ingredients. The rule in question, 19 C.F.R. § 102.11(c), applies where no single foreign ingredient imparts its essential character to the finished product.

The origin rule applied to the frozen vegetable mixtures at issue has been criticized as inconsistent with Section 304 of the Tariff Act of 1930, which requires that a foreign article be marked to indicate to the ultimate purchaser the country of origin of the article but does not extend the marking requirement to foreign ingredients used in producing the article. Under long-standing principles of substantial transformation, a foreign good is considered to be substantially transformed when it is blended as an ingredient with other goods and does not impart its essential character to the finished good. The current Customs position thus is inconsistent with the substantial transformation principle and Section 304.

In both the front-panel marking example and the mixtures example cited above, the Treasury Department and Customs Service adopted an extreme, and legally unsound, interpretation of the marking requirement under Section 304 of the Tariff Act. In both cases, the Treasury/Customs Service decision reversed a long-standing Customs Service interpretation. In both cases, the action by Treasury and Customs was taken following pressure from domestic protectionist interests. GMA believes that these two examples are illustrative of Treasury actions that are inconsistent with U.S. obligations under the Agreement on Rules of Origin. Each is also an illustration of costly and unnecessarily burdensome regulation that creates unreasonable restrictions on the flow of international trade.

III. THE TREASURY DEPARTMENT SHOULD FORMULATE A WORKABLE RULE TO APPLY TO THE COUNTRY OF ORIGIN MARKING OF COMMINGLED FUNGIBLE GOODS

The Part 102 rules do not establish a workable rule to address the country of origin determination that must be made with respect to goods Customs

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1/ *American Frozen Food Institute, Inc. et al. v. United States,* 855 F. Supp. 388 (Ct. Int'l Trade 1994).

2/ 60 Fed. Reg. 6464 (February 2, 1995).

refers to as "commingled fungible goods." The commingled fungible issue arises when a good, or an ingredient imparting the essential character to a finished good, is sourced from multiple foreign countries. Under an existing judicial precedent, such goods in some cases are required to be labeled for more than one country of origin. 3/

Experience under the commingled fungible rule has shown that it is highly impracticable to label commingled fungible goods, in every instance, with a precise list of the source countries for the particular package. Customs has recognized this impracticability and has approved a method known as "major supplier" marking for certain products, including imported fruit juices. 4/ Under the major supplier method of marking, a producer of a commingled fungible good may list on the label up to ten source countries, provided that the producer obtains 75 percent or more of imported material used in a particular lot from among the ten or fewer countries listed on the label.

The current Part 102 rules incorporate a different method of providing the needed flexibility, but they do so merely by including cross references to inventory management methods under the NAFTA uniform preferential country of origin rules. 5/ The application of these inventory management methods in practice is unclear. The Part 102 rules make no mention of the major supplier rule.

GMA recommends that Customs develop workable, practicable marking rules to address the commingled fungible issue. These rules should provide flexibility at least equivalent to that provided by the major supplier rule. GMA further recommends that individual exceptions from the general rule be made available to address situations where compliance with the general rule is impracticable or unduly burdensome on the producer. The availability of such individual exceptions was authorized for fruit juice products by T.D. 89-66. 6/

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Thank you for the opportunity to address these issues, which are important to many of GMA's members.

3/ *See National Juice Products Ass'n v. United States*, 628 F. Supp. 978, 991 (Ct. Int'l Trade 1986) (orange juice products required to be labeled with source countries of imported orange juice concentrate blended in the processing of the finished product).

4/ T.D. 89-66, 23 Cust. B. & Dec. 328.

5/ 19 C.F.R. §§ 102.11(b)(2), 102.12(b), citing the Appendix to 19 C.F.R. Part 181.

6/ T.D. 89-66, 23 Cust. B. & Dec. 328, 334.

Chairman CRANE. Thank you, Ms. Guarino.
Mr. Folkerts.

STATEMENT OF BRIAN FOLKERTS, DIRECTOR, FEDERAL GOVERNMENT AFFAIRS, NATIONAL FOOD PROCESSORS ASSOCIATION

Mr. FOLKERTS. Thank you, Mr. Chairman.

I am Brian Folkerts, director of Federal Government Affairs for NFPA, the National Food Processors Association. NFPA is the voice of the $400 billion food processing industry on scientific and public policy issues. We appreciate the opportunity to appear before the subcommittee today to present testimony on rules of origin issues. I will focus today on the issue of substantial transformation.

I would like to emphasize at the outset two significant points. First, food processing operations transform a food ingredient substantially by changing it from a perishable commodity to a finished shelf-stable consumer product. Second, this concept of substantial transformation should be used to determine the country of origin of a food product.

The Treasury Department has proposed that the preferential rules of origin for NAFTA be extended to the application of nonpreferential rules, including country of origin markings. The Department has said that these rules are not intended to change Customs longstanding interpretation of substantial transformation for determining when foods processed in the United States and containing some foreign ingredients will be regarded as a domestic product.

Although Customs has stated that the substantial transformation standard will apply under these rules of origin, it has nevertheless eliminated that term from those rules, and instead has proposed using changes in tariff classification to determine when a product processed here that includes imported ingredients will be regarded as a U.S. product.

Of particular concern to NFPA is a provision contained in the tariff classification rules that certain fruit, nut, and vegetable preparations shall be treated as a product of the country in which the fresh component was produced. For example, a vegetable is deemed to maintain its foreign origin if it is canned in water, brine, or natural juices, but it is recognized as a product of the United States if it is canned with salt or other nonvegetable ingredients.

The fact is that in all cases, processing transforms perishable foods into nonperishable foods with significantly extended shelf lives. This proposal, if permitted to stand, will materially alter the common and prevailing definition of substantial transformation. We submit that the preservation process is unquestionably a substantial transformation of the product and should still be recognized as such.

Similarly, the change in tariff classification rules makes no allowance for substantial transformation of imported ingredients into new products that are mixtures, such as canned fruit cocktail which combines several different foods, some or all of which may be imported. Such mixtures, once processed, are new products with new names and new uses.

The extension of origin rules for preferential treatment to nonpreferential areas would have an immediate impact on country of origin markings. This application will result in expensive, confusing food labeling requirements. For example, a food company that sources ingredients from several countries would be required to maintain label inventories covering all options. This is expensive and impractical.

So the food company would likely decide to source ingredients from just one country in order to simplify its label inventory and reduce costs. Thus, these rules would unnecessarily interfere with the free flow of food products and ingredients in the world market.

American consumers clearly place their confidence in products processed and prepared under U.S. food quality and safety regulations. Processing is what changes the nature and character of the product and transforms it into a U.S. product. We urge Customs to modify its rules to carry out its intent, not to alter the substantial transformation standard in determining the country of origin of products processed in the United States.

Mr. Chairman, we thank you for holding this hearing and providing us with the opportunity to testify.

[The prepared statement follows:]

Statement of the
National Food Processors Association
Before the
Subcommittee on Trade of the
House Committee on Ways and Means
On Rules of Origin
July 11, 1995

My name is Brian Folkerts, Director, Federal Government Affairs, of the National Food Processors Association (NFPA), on whose behalf I am testifying today. We very much appreciate the opportunity to appear before the Subcommittee and present testimony on rules of origin issues.

NFPA is the voice of the $400 billion food processing industry on scientific and public policy issues involving food safety, nutrition, technical and regulatory matters and consumer affairs. NFPA's scientists and professional staff represent food industry interests on government and regulatory affairs and provide research, technical services, education, communications, and crisis management support for the Association's U.S. and international members, who produce processed and packaged foods, drinks and juices.

Although the food products processed and distributed by the members of NFPA are largely derived from ingredients produced in the United States, a number of members import some of their ingredients from other countries for incorporation into products that are formulated and processed in the United States. In addition, many NFPA members distribute worldwide products processed in the United States, and they accordingly have a very substantial interest in the maintenance of rules of origin and marking that will not interfere unnecessarily with the free flow of food products in the world market.

NFPA today will focus on the issue of substantial transformation which, for many sectors of the food industry, may provide a truer test of origin than a shift in tariff classifications. For many sectors of the food industry, the act of processing a product in the United States, and thereby substantially transforming its character, does not change its classification in the tariff schedule. Our written testimony provides examples of this discordant approach.

NFPA emphasizes two significant points:

1) Food processing - canning, freezing, drying, etc. - transforms a food ingredient substantially by changing it from a perishable commodity to a finished, shelf-stable, consumer product; and

2) In the case of food products, reconciliation of the HTSUS tariff schedule with substantial transformation, which food processing accomplishes, would eliminate any discord between the tariff classification shift concept and the substantial transformation concept as a reliable means of determining origin.

We understand that a major interest of the Subcommittee concerns the proposal by the Treasury Department that the preferential rules of origin for administration of the North American Free Trade Agreement, basing "substantial transformation" on changes of tariff classification, be extended to the application of non-preferential rules, including country of origin marking. The Treasury Department has taken the position that the rules of origin published on January 3, 1994 (59 Fed. Reg. 113), and as proposed for amendment on May 5, 1995 (60 Fed. Reg. 22312), are not intended to change the Customs Service's longstanding interpretation of "substantial transformation" for purposes of determining when foods processed in the United States and containing some foreign ingredients will be regarded as a product of the United States.

Although Customs has stated its intention "that the same standard, substantial transformation, [will be] be applicable" under these rules of origin, it has nevertheless eliminated that term from those rules, and instead has applied a rule under which a change in tariff classification is regarded as the determinant of when a product processed in this country from some foreign imported ingredients will be regarded as a product of the United States.

Of particular concern to NFPA is a note to the specific rules for tariff classification, which provides as follows:

> "Chapter 20 Note: Notwithstanding the specific rules of this chapter, fruit, nut and vegetable preparations of Chapter 20 that have been prepared or preserved merely by freezing, by packing (including canning) in water, brine or natural juices, or by roasting, either dry or in oil (including processing incidental to freezing, packing or roasting), shall be treated as a good of the country in which the fresh good was produced." 19 C.F.R. § 102.20; 59 Fed. Reg. 113.

If the Chapter 20 Note is permitted to stand and to become applicable to all products in the United States processed with at least some foreign origin raw product, the common and prevailing "substantial transformation" as applied to processed fruits and vegetables will be materially altered, directly contrary to Customs' assertion that the new rules of origin are not intended to change existing, longstanding rules of interpretation. We submit that the preservation process whereby a perishable commodity is rendered stable by canning or freezing is unquestionably a substantial transformation of the product and should continue to be recognized as such.

It is of particular concern that the Chapter 20 Note creates false and unreasonably discriminatory distinctions in applying the rules of origin to the domestic processing of foreign origin products, depending upon the packing medium that is used. A fresh vegetable is deemed to maintain its foreign origin if it is canned in water, brine or natural juices, but it is recognized as a product of the United States if it is canned with salt or other non-vegetable ingredients. Similarly, an imported fresh vegetable to which a non-vegetable ingredient, such as butter, oil or spice, is added and frozen, is recognized as a product of the United States, but the same imported fresh vegetable which is "merely" frozen is deemed to retain its foreign origin. The significant difference in this frozen product is not the addition of the non-vegetable ingredient, but the process of freezing itself which constitutes the substantial transformation of the product.

These meaningless distinctions lack any rational basis. In every case, the canning or freezing process results in substantial transformation of the fresh ingredients, regardless of their source. The fresh fruits and vegetables have been cleaned, trimmed of waste and other imperfections, cut into pieces, packed into a container, and either frozen or canned. In either case, perishable foods as they come from the field have been modified in form and transformed into non-perishable foods, with significantly extended shelf lives.

In support of its contention that the rules of origin are intended to codify rather than constitute an alternative to the substantial transformation rule, Customs cites and discusses a number of cases which are said to support this conclusion. 60 Fed. Reg. 22312, 22314 (May 5, 1995). We submit that none of these cases provides support for the Chapter 20 Note determination that imported fruits and vegetables preserved "merely by freezing, by packing (including canning) in water, brine or natural juices . . . shall be treated as a good of the country in which the fresh good was produced." Clearly, the leading case of National Juice Products Association v. United States, 628 F. Supp. 978 (CIT 1986), does not support such a conclusion. The court held that frozen concentrate produced in another country is not substantially transformed in

the United States when the concentrate is diluted by addition of water and essences for sale to consumers in the United States. In that instance, the processing of oranges that materially changed their character occurred in the foreign country. The addition of water in the United States was not regarded as significantly further changing the character of the product. This is quite different from a situation in which an unprocessed raw fruit or vegetable is imported into the United States for the preparation and processing that substantially transforms the food into a finished, shelf-stable consumer product.

Similarly, in Koru North America v. United States, 701 F. Supp. 229 (CIT 1988), the court held that fish that were beheaded, eviscerated and frozen aboard New Zealand ships were substantially transformed when they were processed in Korea by thawing, skinning, boning, refreezing and packaging for shipment to the United States. As Customs itself notes, the court "found that the processing in Korea resulted in a change in the fundamental nature and character of the fresh fish." Customs adds that its Part 102 rules dictate the same result for fish products, without acknowledging that different principles are applied under the Chapter 20 Note when the ingredients are fruits, nuts or vegetables, rather than fish.

Fruit and Vegetable Mixtures and Mixtures of Juices

The change in tariff classification rules makes no allowance for substantial transformation of imported Chapter 20 products as ingredients into new products in the Form of Chapter 20 mixtures.

Examples of mixtures of concern include canned fruit cocktail which consists of a mixture of two or more different foods, some or all of which may be imported. Another example is canned dry beans in tomato sauce; either the beans or the tomato ingredient (or both) may be imported. Such mixtures are new products -- with a new name and a new use. Under the substantial transformation standard there was no question about the newness of such mixtures and no question concerning their country of origin.

Pursuant to the CTC rules for HTSUS 2001-2007 and 2008.19-2008.99 requiring a chapter change for all their imported ingredients, a food processor is unable to claim U.S. origin on a fruit mixture or on a vegetable mixture which contains even one imported Chapter 20 ingredient.

Also of concern are mixtures of fruit juices and mixtures of vegetable juices (HTSUS 2009.90). Pursuant to the CTC rule for HTSUS 2009.90 requiring a chapter change in all imported ingredients, a U.S. food processor would be unable to claim U.S. origin on a mixture of fruit juices or a mixture of vegetable juices which contains an imported Chapter 20 ingredient. Even if a processor were to utilize pieces of a solid Chapter 20 food as an ingredient in juice mixtures, he would be unable to claim U.S. origin.

We submit that Customs' rules should recognize that preparation of fruit mixtures and vegetable mixtures is a substantial transformation of the product and the country of origin becomes the country in which the mixture was prepared.

Implications for Country of Origin Marking

The extension of origin rules for preferential treatment to non-preferential areas would have an immediate impact on country of origin marking, administered by the U.S. Customs Service. In the case of many food products, this application will result in expensive, confusing food product labeling. NFPA has filed extensive comments with Customs Service opposing any modification of country of origin marking rules

which will result in cluttered labels, or the need to maintain inventories of labels reflecting all possible permutations of country of origin variables.

To illustrate the adverse effect are two examples which are hypothetical but reflect realistic situations:

> Imported broccoli from Guatemala, cauliflower from Canada, and water chestnuts from China are blended in the United States with other vegetables, and sold to consumers as a frozen vegetable blend. Despite United States Customs Service interpretation to the contrary, NFPA maintains that this blend is a product of the United States. Blending these vegetables will not change tariff classification; these commodities are Chapter 20 products and would be subject to those provisions. Applying the tariff shift concept to country of origin marking of this frozen vegetable blend would render this a product of Guatemala, Canada, and China - despite the fact that it was blended in the United States, its value was added in the United States, and despite the fact that it is formulated to appeal to the tastes of United States consumers.
>
> A second example is canned fruit cocktail in juice, made with pineapple from Thailand, pears from Germany, and other fruits - peaches, cherries - from the United States. Chapter 20 tariff classification rules apply throughout. Despite the fact that the product is blended and canned in the United States, if the tariff classification shift test is applied, this product's label would state: Product of Thailand and Germany. If, a year later, pears from France are used, for price, quality, or other reasons, the label would have to be changed to read: Product of Thailand and France.

As the United States food industry has recently experienced a complete change in food labels to incorporate mandatory nutrition labeling, NFPA can document that label changes are costly, and cannot be accomplished overnight. A food company which may source ingredients from Germany or France, making decisions based on market factors, would be required to maintain label inventories covering both options. This is expensive and impractical. The net effect would be a barrier to free trade: the food company would likely decide to source ingredients from one country but not the other, in order to simplify its label inventory, reduce costs, and to prevent misbranding by the erroneous application of the incorrect county of origin label. In this realistic example, the rules of origin and marking would unnecessarily interfere with the free flow of food products in the world market.

Conclusion

NFPA submits that the application of rules for preferential treatment under the United States-Canada Free Trade Agreement and now under NAFTA may be appropriate for identifying products eligible for preferential treatment. They are not suitable, however, for determining labeling requirements for country of origin marking and should not be promoted as such. The test for country of origin marking on food products should continue to be substantial transformation, so that the consumer will understand where the product was processed into a canned or frozen consumer product. American consumers clearly place their confidence in products processed and prepared under United States food quality and safety regulations in making their purchasing decisions. It is that processing that changes the nature and character of the product, and transforms it into a product of the United States.

In short, we urge that Customs modify its rules in order to carry out its intent not to alter or change the substantial transformation standard in determining the country of origin of products processed in the United States.

Chairman CRANE. Thank you, Mr. Folkerts.
Is it Stanceu?
Mr. STANCEU. Stanceu.
Chairman CRANE. Stanceu. Very good. You are next.

STATEMENT OF TIMOTHY C. STANCEU, COUNSEL, ON BEHALF OF THE AMERICAN FROZEN FOOD INSTITUTE

Mr. STANCEU. Thank you, Mr. Chairman.

I am Timothy Stanceu and I am pleased to appear before you today on behalf of AFFI, the American Frozen Food Institute. My firm, Hogan & Hartson, serves as general counsel to AFFI. AFFI sincerely appreciates the interest of this subcommittee in the subject of rules of origin and in obtaining the views of affected U.S. businesses.

AFFI's 550-member companies account for more than 90 percent of the frozen food produced in the United States, valued at approximately $60 billion. AFFI's members have a strong interest in rules of origin, both as importers of agricultural products and ingredients and as exporters of finished frozen food products to markets around the globe.

AFFI believes nonpreferential rules of origin must be transparent and impartial. As the WTO Agreement on rules of origin requires, these rules must not be used as instruments to pursue domestic trade objectives. That agreement places the United States and its trading partners under an affirmative obligation to ensure that its rules are not used in this way and that they do not create restrictive, distorting, or disruptive effects on international trade.

As an equally important principle, AFFI believes that in applying rules of origin, the Treasury Department should avoid needless regulatory requirements and burdens. In recent years, the nonpreferential rules of origin as administered by Treasury have not always adhered to the principles I have cited. AFFI has several concerns regarding the current rules and believes that in their current form they should not be promulgated as final rules, nor should they be used as the basis for the U.S. proposal to the WTO in connection with their international work program.

One of AFFI's principal concerns is the way the part 102 rules apply to certain goods known as mixtures or composite goods. Simply stated, these rules provide that mixtures and composite goods for which no single ingredient imparts the essential character to the finished product may have multiple countries of origin. The rules provide specifically that the good will have various countries of origin corresponding to all the ingredients that merit equal consideration for determining the essential character of the good. This result is inconsistent with the principles of substantial transformation.

Under those principles, an imported ingredient that is combined with other ingredients and does not impart the essential character to the finished good is recognized as having been substantially transformed into a new and different article of commerce. The current rule on mixtures also is inconsistent with section 304 of the Tariff Act of 1930 which requires that an article of foreign origin be marked to inform the ultimate purchaser of the country of origin of the foreign article.

Under the plain meaning of section 304, an article may have only one country of origin, with a very limited exception that applies only to so-called commingled fungible goods. Customs has attempted to stretch the marking provision of section 304 to require labeling to disclose the foreign ingredients used to make the finished article. To my knowledge, the courts in decades of precedent have never construed section 304 to hold that an article may have multiple countries of origin except in the commingled fungible instance that I have mentioned.

Mandatory ingredient labeling for country of origin is a serious problem. It creates a substantial disincentive to import and use foreign ingredients in manufacturing. It requires a company to change labels each time a source country changes, and it is a nontariff barrier to trade which, if adopted internationally, would be a barrier to U.S. exports.

Because of these and other deficiencies, the part 102 rule should not be finalized in its current form. Instead, it should be brought into conformity with substantial transformation principles and with section 304 of the Tariff Act.

Mr. Chairman, my final point concerns the question of sound regulatory practice. Treasury and Customs should avoid unnecessary regulatory burdens and regulate only when required and where required to carry out the intent of Congress. There is no reason why U.S. companies should incur new compliance burdens from an additional set of country of origin regulations that may have to be changed when the WTO work program on rules of origin is completed. It is wasteful and costly for an industry to be subject to successive changes in regulations that affect the labeling of its products.

Some regulatory changes involving country of origin markings should be avoided in their entirety. In particular, Treasury and Customs should not require country of origin markings of frozen produce products to appear on the front panel of packages. Additional special marking requirements, including the requirement for front panel marking, are not necessary for the frozen produce industry. Such a requirement would be unduly burdensome and unjustified by any benefit to consumers. A requirement for front panel marking would disturb a longstanding Customs practice and establish a dangerous precedent for all packaged goods.

Mr. Chairman, thank you for this opportunity to present the views of the American Frozen Food Institute. I would be pleased to answer any questions.

[The prepared statement follows:]

STATEMENT OF TIMOTHY C. STANCEU, COUNSEL ON BEHALF OF AMERICAN FROZEN FOOD INSTITUTE

I appreciate this opportunity to testify on behalf of the members of the American Frozen Food Institute ("AFFI") regarding United States rules of origin. I am Timothy C. Stanceu, partner with the law firm of Hogan & Hartson. The firm serves as AFFI's general counsel. AFFI is the national trade association representing manufacturers and processors of frozen food products, as well as their marketers and suppliers. AFFI's 550 member companies account for more than 90 percent of the total annual production of frozen food in the United States, valued at approximately $60 billion. Prior to joining Hogan & Hartson, I served as Deputy Director of the Office of Trade and Tariffs Affairs, U.S. Department of the Treasury.

AFFI applauds the Chairman for convening this hearing and the members of the Subcommittee on Trade for their efforts to ensure that U.S. rules of origin are fair and transparent. AFFI would like to take this opportunity to express some concerns with the U.S. Customs Service's ("Customs" or "Customs Service") actions regarding country of origin marking requirements and proposed rules of origin.

AFFI's membership, which includes major U.S. frozen food exporters and U.S. frozen food manufacturers that use imported ingredients in their products, is directly affected by rules of origin applied for customs purposes and has a continuing interest in ensuring that any changes in these rules do not have disruptive effects or impose unnecessary compliance costs and burdens on the U.S. frozen food industry. AFFI also is interested in ensuring that any internationally-harmonized rules adopted under the World Trade Organization (WTO) Agreement on Rules of Origin ("Agreement") will not pose barriers to the sale of U.S. frozen food products in markets around the world.

With respect to the latter point, AFFI sees substantial value in the international effort to develop transparent, impartial, and harmonized nonpreferential rules of origin. AFFI strongly supports the goals embodied in the Agreement that resulted from the Uruguay Round of multilateral trade negotiations, including the disciplines applying during the present transition period and the period thereafter.

With particular respect to the present transition period, AFFI considers it noteworthy that member countries, in the words of the Agreement, "shall ensure that ... notwithstanding the measure or instrument of commercial policy to which they are linked, their rules of origin are not used as instruments to pursue trade objectives directly or indirectly." Agreement, Article 2(b). It is equally significant that the Agreement require member countries to "ensure that ... rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade." Agreement, Article 2(c).

I. The U.S. Customs Service's Proposed and Interim Rules of Origin Are Inconsistent with the Substantial Transformation Principle and U.S. Law

AFFI notes that the U.S. Trade Representative, in his April 19, 1995, request to the International Trade Commission ("ITC," or "Commission") for initiation of the investigation under Section 332 of the Tariff Act of 1930, specifically called for a technical review of Customs' proposed and interim "change of tariff classification" provisions in 19 C.F.R. Part 102 ("Customs Part 102 Rules"). AFFI believes these rules are deficient, both from a legal and a trade policy standpoint, in a number of respects and urged the Commission in comments submitted June 15, 1995, not to adopt them as a U.S. proposal for purposes of international harmonization.

A. The U.S. Customs Service's Part 102 Rules Depart from the Principle of Substantial Transformation

In formulating the Customs Part 102 Rules, the Customs Service departed from established substantial transformation principles with respect to a class of products that Customs refers to as "mixtures and composite goods." Some of the goods falling into this category are produced by AFFI members, including mixtures of frozen vegetables and mixtures of frozen fruits. As applied to these frozen food products, the Customs Part 102 rules yield results that not only depart from the established substantial transformation principles, but also as discussed below are unworkable as a practical matter and are inconsistent with U.S. law.

The established substantial transformation principles are intended to identify situations in which the processing of a foreign article in the situs country results in a "new and different article of commerce." As this Subcommittee is aware, the substantial transformation principle recognizes a new and different article of commerce in instances in which the processing in the situs country results in a change in the name, character, or use of the product.

In some cases, the new article emerging from processing in the situs country has a different essential character from any single ingredient, foreign or domestic, used in its production. In such cases, the courts correctly have concluded that a foreign material or ingredient used in that processing has been substantially transformed. See, e.g., Koru North America v. United States, 701 F. Supp. 229, 234 (fish fillets produced from whole headed and gutted fish held to have "vastly different" character and "no longer possess essential shape of the fish"); Diamond Match Co. v. United States, 49 C.C.P.A. 52, C.A.D. 796 (1962) (wooden stick substantially transformed when combined into "ice cream on a stick" product); Grafton Spools, Ltd. v. United States, 45 Cust. Ct. 16, C.D. 2190 (1960) (imported ribbon spool substantially transformed when combined with ribbon product). United States v. International Paint Company, Inc., 35 C.C.P.A. 87, C.A.D. 376 (1948) (imported concentrated paint in paste form lacked essential character of finished anti-fouling marine paint until additional ingredients were added).

In other cases, a single foreign material or ingredient imparts its essential character to the finished product. In such cases, the courts have held that the imported material or ingredient is not substantially transformed. National Juice Products Ass'n v. United States, 628 F. Supp. 978, 991 (Ct. Int'l Trade 1986) (essential character of finished orange juice products imparted by the imported concentrated orange juice for manufacturing incorporated therein); Uniroyal, Inc. v. United States, 542 F. Supp. 1026 (Ct. Int'l Trade 1982) (imported leather upper used to produce deck shoe held to be "very essence of finished product" and therefore not substantially transformed).

The Customs Part 102 Rules ignore the clear distinction in the case law between materials used in processing that impart the essential character to the finished article and those that do not. Specifically, under § 102.11(c) of those rules, a good for which origin cannot satisfactorily be determined under the tariff change rules of § 102.20, and for which no single foreign material imparts the essential character, is determined to have the countries of origin of all materials that "merit equal consideration for determining the essential character of the good." In other words, such a good will have multiple countries of origin corresponding to the countries of origin of the ingredients or materials used to produce the good.

AFFI submits that the Customs Part 102 Rules, as applied to mixtures and composite goods, reach a result that never could have been reached under the substantial transformation principle. Under all the case law concerning substantial transformation, a good has only one country of origin--that of the last country in which processing of that good resulted in a substantial transformation--with one exception applying to certain commingled fungible goods. This exception, which is limited to the country of origin marking context, stems from the decision of the Court of International Trade in National Juice Products Ass'n v. United States, supra. The Court held that orange juice products that underwent processing in the United

States and in which frozen concentrated orange juice from different source countries was combined were of foreign origin and therefore subject to the country of origin marking requirement under Section 304 of the Tariff Act of 1930. The court noted that even though the processing included the addition of certain minor ingredients, the imported frozen orange juice concentrate imparted the essential character to the finished product.

The "commingled fungible" marking rule established by National Juice Products Ass'n, unlike the rule contained in § 102.11(c), arguably is consistent with the essential character principle as embodied in substantial transformation precedents. In situations in which the imported ingredient imparts the essential character to the finished good, the latter, according to the reasoning in National Juice Products Ass'n, is not a new and different article of commerce, even though the imported ingredient may have been sourced in multiple countries. The principle of National Juice Products Ass'n is confined to the marking context.

The opposite conclusion applies where the foreign material or ingredient does not impart the essential character to the finished good. In such a case, there can be only one country of origin for the good, and it corresponds to the country in which the last substantial transformation occurred.

B. The U.S. Customs Service's Part 102 Rules Are Inconsistent with Section 304 of the Tariff Act of 1930, as Amended

Applied in the marking context, the Customs Part 102 Rules are not consistent with the plain meaning of Section 304 of the Tariff Act of 1930, as amended. As you know, Section 304 provides, with some exceptions, that:

> every article of foreign origin (or its container ...) imported into the United States shall be marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the article (or container) will permit in such a manner as to indicate to an ultimate purchaser in the United States the English name of the country of origin of the article.

19 U.S.C. 1304(a) (emphasis added). Section 304 plainly provides that an article of foreign origin, or its container, must be marked to indicate its own country of origin. Section 304 cannot reasonably be interpreted to require a producer to mark a finished good to inform the ultimate purchaser of the countries of origin of the various foreign materials used to make the good. In this regard, AFFI finds no merit in the current Customs view that the ingredients in some mixtures are to be treated, for marking purposes, as separate articles. An article produced by combining different ingredients into a mixture is, by definition, a single article.

Despite the clear tenets of the established transformation principle and the express language of Section 304, Customs adheres to the implausible contention that an article produced by mixing or combining different foreign ingredients, no one of which imparts the essential character, may be considered an article of foreign origin and may even have multiple countries of origin. Such a result would be permissible only if Section 304 extended the marking obligation to foreign ingredients. Plainly, Section 304 does not do so. Congress enacted Section 304 to ensure that the ultimate purchaser of a *foreign article* is informed of the country of origin of *that article*. There was no Congressional intent to inform the ultimate purchaser of the country of origin of the foreign-sourced ingredients that were used to produce an article in the United States.

The Customs position embraces a fundamental contradiction in attempting to treat a mixture, which is by definition a single product made from different components or ingredients, as a group of separate articles for purposes of Section 304.

AFFI believes the U.S. should not include in any positions or proposals before the WTO or the World Customs Organization a rule of origin which, if applied in the marking context, is inconsistent with a U.S. trade statute such as Section 304.

II. The U.S. Customs Service's Part 102 Rules Do Not Comply with the Requirements of the WTO Agreement on Rules of Origin

As noted previously, nonpreferential origin rules applied directly or indirectly as instruments of a country's trade policy violate the disciplines established by the WTO Agreement on Rules of Origin. Similarly, member countries are to ensure that their rules of origin do not create restrictive, distorting, or disruptive effects on international trade. The Customs Part 102 Rules fail to meet either of these disciplines.

In the country of origin marking context, the Customs Part 102 Rules as applied to mixtures require a producer to change its labels or marking each time it changes the source country of a significant ingredient, even if that ingredient does not impart the essential character to the finished product. In so doing, those Rules create a substantial disincentive to import and use foreign ingredients in manufacturing. Although such a measure might be favored by U.S. producers of a particular ingredient, the unwarranted and unprecedented extension of the country of origin marking requirement is a thinly-disguised attempt to create a non-tariff barrier.

AFFI notes that in the debate preceding the passage of the Uruguay Round Agreements Act late last year, Congress considered and rejected a limited amendment that would have required imported products containing foreign-origin peanuts as an ingredient to be labeled to disclose the country of origin of the peanuts. By adhering to its current position applicable to the country of origin of mixtures, Customs has gone far beyond the limited measure Congress considered and rejected. Were Congress now to enact such a measure, or a broader measure of the type embodied in § 102.11(c), U.S. trading partners correctly could object that the United States has failed to adhere to its obligations under the Uruguay Round Agreement on Rules of Origin. In fact, the United States doubtless would object strenuously were other countries to propose such a trade-restrictive measure on U.S. exports.

In the general tariff context, the Customs Part 102 Rules are completely unworkable. For general tariff purposes, a good may have only one country of origin. Attributing multiple countries of origin to a single good, based on the countries of origin of the significant foreign ingredients, poses extreme difficulties for the efficient processing of goods in international customs transactions. Where, for example, different tariff rates apply to goods of different countries (as is the case under U.S. tariff law with respect to Column 2 countries), a single good must be subjected to multiple valuations and assessments of duty corresponding to the various ingredients. Such an approach unavoidably will have restrictive and disruptive effects on international trade, particularly if applied as a harmonized international principle.

III. The United States Should Adhere to Established Substantial Transformation Principles in its Deliberations and Proposals under the Agreement on Rules of Origin

AFFI suggests specific changes be made to the Customs Part 102 Rules addressing the treatment of mixtures and composite goods. AFFI believes conforming changes to § 102.20 to address the Chapter 7 rules for change in tariff classification, as well as Chapter 3 rules for fish meat products, are necessary.

The tariff change rule in § 102.20 which applies to frozen produce products should be revised as follows:

07.10 ..... A change to heading 07.10 from any other chapter, **or a change to subheading 0710.90 from any other subheading, provided that no single vegetable ingredient of foreign origin constitutes more than 75 percent of the weight of the product.**

This change will clarify the application of the Rules of Origin to mixed produce products. In instances in which a single vegetable ingredient constitutes more than 75 percent of the weight of the product, the tariff change rules will not resolve the issue of origin, and the origin would be determined according to the essential character rule of § 102.11(b).

The existing tariff change rule in § 102.20 applying to fruit juices requires a revision for similar reasons. As written, the rule would ignore the established legal principle that a foreign material that does not impart the essential character to the finished product is not an "article of foreign origin" for purposes of Section 304 of the Tariff Act of 1930, as amended. A mixture of fruit juices may have 60 percent of its volume from a single country, yet be substantially transformed in the country of processing; for example, a change in essential character may result from the addition of the remaining 40 percent. For consistency with established principles under Section 304, the rule should be revised as follows:

2009.90 ..... A change to subheading 2009.90 from any other chapter; or

A change to subheading 2009.90 from any other subheading, provided that a single juice ingredient of foreign origin ~~**or juice ingredients from a single foreign country,**~~ constitutes in single strength form no more than 60 percent by volume of the good.

Under AFFI's recommended changes, a mixture or composite good to which no single foreign ingredient imparted the essential character would have the origin of the last country in which the good underwent non-minor processing. The country of origin would be that country in which were combined the various different ingredients, consistent with the established principles of substantial transformation.

With regard to fish meat products, the tariff change rule for heading 03.04 would treat as a substantial transformation the processing of whole fish into fillets but, paradoxically, would recognize no substantial transformation in the processing of whole fish into fish meat. The principle established by the Court of International Trade in *Koru North America* v. *United States*, 701 F. Supp. 229 (Ct. Int'l Trade 1988) is broader than the narrow holding that processing whole fish into fillets is a substantial transformation. Production of fish meat products from whole fish requires as much or more processing than production of fillets from whole fish. The principle of the *Koru North America* decision is that the change in shape in the processing of fillets produces a product with a different essential character and commercial identity. This principle applies equally to fish meat products, as fish meat does not retain the shape, character, or commercial identity of a whole fish. The rule as written therefore is internally inconsistent as well as inconsistent with the *Koru North America* decision. The tariff change rule for heading 03.04 should be revised to read:

03.04 ..... A change to heading 03.04 from any other **heading**.

AFFI believes Customs also must make revisions to the definition of minor processing and application of the "de minimis" rule. The definition of minor processing in § 102.1 (m) includes, in subparagraph (5), "[u]nloading, reloading, or any other operation necessary to maintain the good in good condition." This language appears overly broad and could be misinterpreted to apply to industrial operations necessary to preserve a good but which also alter the essential character of the good or otherwise amount to significant processing or which add value. AFFI recommends the language be revised to read: "[u]nloading, reloading, or any other **unsubstantial** operation **that does not add significant value to the good and is performed solely to preserve or maintain the good in good condition for shipment**.

Customs has precluded application of the de minimis rule of § 102.13 to food products in § 102.13 (b). AFFI sees no need for this limitation. First, with respect to the "essential character" issue, a single foreign material constituting no more than 7 percent of the value of the good will not impart the essential character. Therefore, extending the de minimis rule to

the food chapters of the Harmonized System will promote ease of application in cases in which a minor ingredient fails to undergo a qualifying tariff shift.

The de minimis rule also will serve a valid purpose with respect to commingled fungible goods. Customs should adopt "major supplier" marking rules to simplify compliance with marking requirements in the difficult case of commingled fungible goods. In the context of major supplier rules, materials present that amount to no more than 7 percent of the value will not materially affect the outcome of those rules but will simplify their application. The de minimis rule, in conjunction with major supplier marking, will promote the overall interest in reducing administrative burden.

IV. The U.S. Customs Service Should not Mandate Front Panel Country of Origin Marking For Frozen Produce

As a general matter, AFFI believes an agency should regulate an industry only where necessary, and only to the extent necessary, to achieve the purpose of the relevant statutory provision. Accordingly, any new regulation that would impose additional costs and burdens on an industry must be justified by a clear and compelling need. Customs currently is considering whether to issue a proposed rule establishing special country of origin marking requirements for frozen produce with imported content. AFFI's position is that such a rule is unnecessary and needlessly would burden the U.S. frozen produce industry.

AFFI has been embroiled in a debate with Customs with regard to whether Section 304 of the Tariff Act of 1930, as amended, is fulfilled only if country of origin marking is located on the front, or principal display, panel of frozen produce packaging. AFFI does not believe front-panel marking is the only "conspicuous" place on packages of imported frozen produce for country of origin marking purposes. The plain meaning of the relevant language in Section 304 illustrates that front-panel marking is not necessary for imported frozen produce. Section 304(a)(1) provides, in pertinent part, that

> every article of foreign origin (or its container, as provided in subsection (b) hereof) imported into the United States shall be marked *in a conspicuous place* as legibly, indelibly, and permanently as the nature of the article (or container) will permit in such manner as to indicate to an ultimate purchaser in the United States the English name of the country of origin of the article.

19 U.S.C. 1304(a)(1) (emphasis added). Section 304 does *not* require that the country of origin must appear in the *most* conspicuous place, nor does it require that the marking be as conspicuous as the article or container will permit. Congress chose different, and less restrictive, words to express the conspicuous place requirement than it chose to express the other three requirements, *i.e.*, the requirements that the marking be as legible, indelible, and permanent as the nature of the article or container will permit in such manner as to indicate the country of origin to the ultimate purchaser.

Customs itself has long recognized that Section 304 does not require marking in the *most* conspicuous place. It consistently has so held with respect to products of various descriptions and, until the December 29, 1993, issuance of Treasury Decision 94-5 (T.D. 94-5), maintained this interpretation with respect to marking of imported frozen produce. T.D. 94-5 mandated front panel country of origin marking for frozen produce with imported content and specified the precise manner in which the marking must appear on product packages. T.D. 94-5 thus constituted a major, and unwarranted, departure from consistent past practice. *See e.g.*, HRL 734662 (October 8, 1992) (marking of ski boot acceptable if located on bottom of boot); HRL 734523 (July 24, 1992) (fence post held acceptably marked even though marking was not in the "most conspicuous location"); HRL 734530 (June 29, 1992) (automotive replacement glass properly marked where marking is in a place where ultimate consumer can easily find it,

though not necessarily in the most conspicuous location); HRL 732874 (January 13, 1990) (article "need not be marked in the most conspicuous place, but merely in any conspicuous place which shall not be covered or obscured by subsequent attachments or arrangements").

Prior to T.D. 94-5, Customs consistently had ruled that front panel marking of frozen produce was not necessary. In 1988, domestic packers requested that Customs issue a ruling such that packaged imported frozen produce would not be considered to be marked in a conspicuous place unless the marking appeared on the front side of such packaging in prominent lettering. On November 21, 1988, Customs responded by issuing a determination that the sample packages submitted by the domestic packers were legally marked by names and words which appeared on the back side of the packaging in close proximity to nutritional information required under regulations of the Food and Drug Administration (FDA) HRL 731830 (November 21, 1988). In the ruling, Customs specifically stated,

> We believe the proper sources for defining the word "conspicuous" are the statute itself, the regulations issued thereunder and court decisions made in light of both of these... In addition, we note the lack of any Congressional action to modify the statute in any way that would result in your interpretation of "conspicuous". Our interpretation and application of 19 U.S.C. 1304 have been well known for many years.

HRL 731830 (November 21, 1988).

When the domestic packers brought a judicial challenge to the Customs determination in HRL 731830, the Court of International Trade (CIT) ruled in their favor, ordering Customs to require front-panel marking of frozen produce. *Norcal/Crosetti Foods, Inc., et al.* v. *U.S. Customs Service*, 758 F. Supp. 729 (1991); *rev'd*, 953 F.2d. 356 (Fed. Cir. 1992). Customs relied on this decision as part of its rationale for requiring front-panel marking in T.D. 94-5. This reliance is misplaced. No weight should be given to the CIT decision. First, the Federal Circuit's reversal on jurisdictional grounds established that the matter was not properly before the Court of International Trade and, accordingly, that the decision is not a valid precedent. Second, the reasoning of the CIT's decision is erroneous in numerous respects. For example, AFFI notes that the Court, in stating its conclusion, confused the conspicuousness requirement with the legibility requirement, erroneously assuming that Section 304 requires that marking be as conspicuous as the package will permit, as evidenced by the following statement:

> The markings [on the packages examined by the Court] are not *as conspicuous or as legible as the packages will permit*: a glance at the front panel reveals an abundance of space which would accommodate the mandated disclosure more legibly than at present.

758 F. Supp. at 741 (emphasis added). The Court provided no reasonable justification for its conclusion that marking on a side or rear panel, even if properly printed so as to be readily legible and apparent to the consumer, could not be "in a conspicuous place" within the meaning of Section 304. The Court offered as a reason for its conclusion the fact that frozen produce is displayed in freezers and is "cold to the touch." Any purchaser of frozen produce knows the package is not so cold as to prevent the purchaser from removing it from the freezer display and carrying it to the check-out counter. Nothing prevents the consumer from examining the package, including the rear panel, to obtain information concerning the product.

It is important to note that as late as September of 1993 Customs remained dedicated to its position regarding the adequacy of back-panel country of origin marking. In fact, the notice of Receipt of Domestic Interested Party Petition Concerning Country of Origin Marking of Frozen Produce stated "Customs regards the findings of HRL 731830 as having been effectively reinstated, such that marking on the back panel of a package of frozen produce is an acceptable practice in the absence of any other factors which might require more extensive

disclosure." 58 Fed. Reg. 47414 (September 9, 1993).

Following a lawsuit filed in February 1994 by AFFI and other parties, T.D. 94-5 ultimately was declared by the Court of International Trade to be "null and void." *American Frozen Food Institute, Inc. et al.* v. *The United States*, 855 F. Supp. 388 (Ct. Int'l Trade 1994). As a result, no legal precedent exists for requiring front panel country of origin marking of frozen produce with imported content.

On February 2, 1995, Customs published an advance notice of proposed rulemaking which solicited comments on a number of issues related to two broad aspects of country of origin marking for frozen produce. The first of these addressed whether new Customs rules are needed to ensure a uniform standard for conspicuous and legible markings. The second addressed that which should be included in any new rules if, after reviewing the comments its received, Customs determines that new rules are necessary.

AFFI believes Customs should take into account the Food and Drug Administration's rules and regulations governing the frozen produce industry when considering any rulemaking procedures. FDA's regulations are a reflection of Congress' concern with ensuring that consumers have access to complete, accurate and consistent nutrition information. Notwithstanding this issue of paramount concern to Members of Congress and the consuming public, there never was any consideration of including this critical information on the front panel; as a result, there is very important information included on the back panel of product labeling, including nutrition information and ingredient listings. Absent evidence of Congressional intent to the contrary, there is no authority for elevating country of origin labeling above the importance of nutritional information required by FDA to appear on the back panel.

AFFI believes there is no justification for new regulations governing country of origin marking of frozen produce with imported content. Industry should not be forced to comply with unnecessary and costly regulations. Because there is no legitimate reason to single out frozen produce products for additional country of origin marking requirements, any such regulation would be arbitrary and capricious and would raise the expectation that Customs will promulgate similar regulations for other classes of imported goods, particularly other products packaged and offered to the ultimate purchaser in cardboard boxes and plastic bags. Certainly, there is no need or justification for Customs to promulgate regulations dictating specific requirements for the location, size and style of marking on all the various classes of imported goods.

V. Conclusion

In summary, AFFI believes Customs must revise the Part 102 Rules to bring them into conformity with the comments provided herein. AFFI also believes Customs should not promulgate non-NAFTA rules of origin prior to the implementation of the results of the work program under the Uruguay Round Agreement on Rules of Origin. Customs should be guided by the principle that an industry should not be forced to cope with multiple successive changes in the same regulation that could be avoided by sound regulatory practice. Finally, Treasury and Customs should refrain from instituting unnecessary country of origin marking requirements, such as the previously-considered "front panel" marking requirement, that unjustifiably burden affected industries.

AFFI appreciates the opportunity to provide this testimony and offers any additional assistance you deem appropriate.

Chairman CRANE. Thank you, Mr. Stanceu.
Ms. Kline.

STATEMENT OF LINDA M. KLINE, BUSINESS TEAM LEADER, PILLSBURY CO., MINNEAPOLIS, MINN.

Ms. KLINE. Thank you, Mr. Chairman.

My name is Linda Kline and I am a business team leader with the Pillsbury Co. On behalf of Pillsbury, I appreciate the opportunity to testify before this subcommittee.

Pillsbury is a major food producer in the United States with more than 15,000 employees nationwide. Pillsbury uses both U.S.-grown and imported ingredients in its food products, and it is substantially affected by the proposed rules of origin.

The currently proposed rules would have a significant impact on the way Pillsbury conducts its business. These rules of origin would require Pillsbury to identify the country of origin of each of its vegetable ingredients in our mixed vegetable products.

Until very recently, Pillsbury's mixed vegetable products have never required country of origin markings, although one or more of the vegetable ingredients was imported. The reason was a recognition that the imported ingredient was substantially transformed in the United States when combined with a variety of vegetables to form a mixed vegetable side dish. In other words, it was a new and different article of commerce.

In 1988 Customs issued a duty drawback ruling that implicitly recognized that our mixed vegetable products were substantially transformed. Customs changed its position in a ruling regarding one of our products in 1993 and now seeks to extend that ruling industrywide. However, those rules are inconsistent with the substantial transformation test when properly applied.

I would like to explain to you why our mixed vegetable products are new and different articles of commerce that should not require country of origin ingredient labeling. The consumer is purchasing a particular precise combination of vegetables. It's the flavor, appearance, and texture of the vegetables in combination with one another that matters.

The production of these goods has required an investment in the United States of many millions of dollars in the blending equipment alone. The burden of identifying the country of origin of the individual ingredients in our mixed vegetable products is enormous. It requires that we track the source of each vegetable that goes into each of our products and then match those sources to a particular corresponding label.

Pillsbury uses multiple foreign, as well as domestic, sources for our vegetable products. This is necessary to ensure a year-round supply of freshly harvested vegetables since the supply is seasonal. The quality of vegetables, even when frozen, deteriorates over time and Pillsbury maintains vegetables in inventory for as little as 2 weeks in order to maintain freshness.

Also, as with any agricultural commodity, a source of supply may suddenly be shut off because of adverse weather conditions or other natural disasters. We have found that we simply cannot maintain our normal sourcing because of Customs rules.

First, tracking the source of every peapod, broccoli floret, cauliflower stalk, water chestnut, and red pepper slice whether U.S. or foreign sourced would require that Pillsbury develop a highly sophisticated multimillion-dollar computer system like that offered by Federal Express, even if it could be done. But Pillsbury is in the business of producing vegetable products, not delivering packages. There is absolutely no evidence that consumers want to pay us to perform the complex and extremely expensive tracking services that Customs would require.

Second, it can literally be impossible to match the particular source to a particular label. It takes 4–6 weeks to order new labels, whereas, we may need to change suppliers in a matter of days. The alternative of maintaining huge inventories of labels that would include every potential country of origin for each of the 4 or 5 ingredients in our products would result in tremendous waste and inefficiency.

In order to cope with the new country of origin rules, Pillsbury has instead had to restrict its sourcing to countries that match the labels we have on hand. We have had to forgo purchasing better quality and more economical vegetables because we couldn't get new labels in time. This is a clear example of marking rules restricting foreign trade.

The irony is that on several occasions we have had to turn down contracts with American growers because our available labels indicated foreign sources. In addition, American growers are harmed by this rule because the United States has relatively short growing seasons. Because we have had to reduce multiple sourcing, we have to favor countries that can provide vegetables for the longest period of time. This label restriction is preventing us from delivering the best quality product at the best price to the consumer.

All of this needs to be viewed in the context of the importance of the country of origin of the source of each of the vegetable ingredients to consumers. I participated in many market research studies asking consumers what they care about in selecting vegetable products. The country of origin is not a material factor. Instead, consumers care about taste, price, quality, brand name, nutritional information, and convenience of preparation. This data is consistent with the results of a survey conducted by Fields Research which found that hardly anyone was concerned about the country of origin of their mixed vegetable products.

In conclusion, the rules that Customs is seeking to change have been in existence for 50 years and are currently under review by the WTO. Customs proposed enactment of more restrictive and costly country of origin rules, despite the fact that labeling would likely have to be changed again once the WTO makes its determinations, and despite the clear mandate by NAFTA to reduce trade barriers, is an excellent example of government over regulation. Pillsbury urges that Customs currently retain the traditional substantial transformation marking rule, as well as its longstanding practices pertaining to location and type size requirement.

Thank you.

[The prepared statement follows:]

TESTIMONY OF LINDA M. KLINE, BUSINESS TEAM LEADER, THE PILLSBURY COMPANY, BEFORE THE SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS, ON THE SUBJECT OF RULES OF ORIGIN IN INTERNATIONAL TRADE

July 11, 1995

On behalf of the Pillsbury Company, I appreciate the opportunity to testify before this Committee on the subject of rules of origin. Pillsbury is a major U.S. producer of food products, which it manufactures under the Pillsbury®, Green Giant®, Häagen-Daz®, Old El Paso®, and Progresso® brands and other brands. As a major food manufacturer with more than 16,000 employees in the United States, and as an exporter of food products to markets around the world, Pillsbury is affected directly and substantially by the administration of the rules of origin applied to goods in international commerce.

Pillsbury commends this Committee for its interest in the subject of rules of origin, its concern regarding the current administration of rules of origin by the U.S. Treasury Department, and its goal of ensuring that the United States has a coherent position in the World Trade Organization ("WTO") discussions on the international harmonization of origin rules. In particular, Pillsbury is appreciative of this Committee's interest in hearing from the U.S. business community on the application of both preferential and non-preferential origin rules.

In my testimony today, I shall present four principal points on behalf of Pillsbury:

I. The U.S. Customs Service ("Customs Service" or "Customs") should conform its current Part 102 rules of origin with:

A. the established principles of substantial transformation;

B. the U.S. obligations under the World Trade Organization ("WTO") Agreement on Rules of Origin; and

C. Section 304 of the Tariff Act of 1930.

This will require changes to the treatment of mixtures and composite goods under the Part 102 rules, which are now being applied on an interim basis in the context of the North American Free Trade Agreement ("NAFTA"). Those rules now attribute multiple countries of origin to certain mixtures, based on the various countries of origin of the ingredients used to produce the mixtures. As such, the current rules are inconsistent with substantial transformation principles, Section 304 of the Tariff Act, and the Agreement on Rules of Origin. The latter requires that member countries not use their origin rules as instruments to pursue trade objectives and not allow their origin rules to create restrictive, distorting, or disruptive effects on trade.

II. Customs should defer to the substantial transformation principle during the period that the Treasury Department is bringing the Part 102 rules into conformity with established principles and precedents as called for in my first point.

III. The Treasury Department and Customs Service should delay issuance of general, non-preferential origin rules pending the implementation of the results of the WTO work program to develop internationally-harmonized origin rules;

IV. The Treasury Department should institute a moratorium on any new country of origin regulations that impose new marking or labeling

burdens and requirements on affected industries. The moratorium should continue until the United States implements the final results of the WTO work program. In this way, Treasury and Customs would minimize regulatory costs and burdens by ensuring that affected U.S. companies will not be forced to comply with marking and labeling changes during the transition period, only to be required to change their labels again when the results of the WTO work program are implemented into U.S. law.

Pillsbury is pleased to provide this Committee its views concerning current and future administration of non-preferential origin rules. Pillsbury is especially concerned with the effect of the current Customs non-preferential origin rules on a particular class of mixtures: packaged frozen food products consisting of combinations of different vegetables. Pillsbury and other U.S. frozen food manufacturers produce these products in the United States, using domestically-grown and imported produce. The interim Part 102 rules would attribute to frozen produce mixtures multiple countries of origin corresponding to the countries of origin of the various ingredients, even though no single ingredient imparts the essential character to the finished product. Pillsbury submits that where no single ingredient imparts the essential character to the finished product, the finished product, under any plausible origin rule, must be considered to be a new and different article of commerce. Accordingly, the current Customs non-preferential origin rules are in need of substantive change. In their current form, these rules are not suitable as the basis for international harmonization of origin rules.

I shall now address, in additional detail, the points summarized above.

I. Customs Should Conform the Part 102 Rules with the Principles of Substantial Transformation, with U.S. Obligations under the WTO Agreement on Rules of Origin, and with Section 304 of the Tariff Act of 1930

A. Inconsistency with the Substantial Transformation Principle

The current Part 102 rules are a misguided and unworkable approach, under which some mixtures and composite goods are determined to have the country or countries of origin of the foreign materials or ingredients used to produce them, even though these mixtures and composite goods, when viewed according to the substantial transformation principle, are new and different articles of commerce.

Where, under the Part 102 rules, the origin of a mixture or composite good cannot be determined under § 102.11(a) or (b), § 102.11(c) ascribes to that good the country or countries of origin of all materials that "merit equal consideration for determining the essential character of the good." Because § 102.11(c) applies only where origin cannot be determined under § 102.11(b), it finds application only where no single foreign material imparts the essential character to the finished good, *i.e.*, where the finished good, by definition, has an essential character different from that of any foreign material used to produce it. As a matter of logic as well as established precedent, any such finished good must constitute a new and different article of commerce, compared with any single foreign material used as an ingredient.

The substantial transformation principle requires that a foreign good processed in the situs country be recognized as substantially transformed into a new and different article of commerce, where that foreign good does not impart its essential character to the finished good. *See, e.g., United States v. Gibson-Thompsen Co., Inc.*, 27 C.C.P.A. 267 (1940) (imported wooden hairbrush and toothbrush handles substantially transformed into new and different articles of commerce when combined with bristles to form finished brushes); *Koru North*

America v. United States, 701 F. Supp. 229 (Ct. Int'l Trade 1988) (headed, de-tailed and gutted fish lose essential character when processed into frozen fish fillets held to have "vastly different" character and to "no longer possess essential shape of the fish"); *Diamond Match Co. v. United States*, 49 C.C.P.A. 52, C.A.D. 796 (1962) (wooden stick loses its commercial character when combined to form "ice cream on a stick" product); *Grafton Spools, Ltd. v. United States*, 45 Cust. Ct. 16, C.D. 2190 (1960) (character of imported ribbon spool subsumed into character of finished ribbon product); *United States v. International Paint Co., Inc.* 35 C.C.P.A. 87: C.A.D. 376 (1948) (imported concentrated paint in paste form substantially transformed by removal of impurities and addition of varnish). Contrary to this fundamental, long-standing principle, § 102.11(c) attributes multiple foreign countries of origin to certain mixtures and composite goods. In so doing, § 102.11(c) fails to recognize the substantial transformation that occurs upon the combining of different foreign ingredients, no one of which imparts the essential character to the finished product.

The treatment of certain mixtures and composite goods under § 102.11(c) contrasts with the treatment of other mixtures and composite goods under § 102.11(b), which correctly embodies the substantial transformation principle. Under the latter, no substantial transformation of a foreign material or ingredient is found to occur where that material or ingredient imparts its essential character to the finished product. This result is consistent with decisions of the courts. *See, e.g., National Juice Products Ass'n v. United States*, 628 F. Supp. 978, 991 (Ct. Int'l Trade 1986) (imported concentrated orange juice for manufacturing imparted essential character to finished orange juice products); *Uniroyal, Inc. v. United States*, 542 F. Supp. 1026 (Ct. Int'l Trade 1982) (imported leather upper to which sole was attached was "very essence" of finished product).

When judged according to the substantial transformation rule, § 102.11(c) of the Part 102 rules is internally inconsistent and self contradictory: it applies *only* where no single foreign ingredient imparts the essential character to the finished good, yet, in refusing to recognize the substantial transformation that has occurred, it paradoxically treats the finished good as if it had the same essential character as the imported ingredient or ingredients.

B. Inconsistency with the WTO Agreement on Rules of Origin

The WTO Agreement on Rules of Origin is intended to effectuate the principle that rules of origin should be administered in a neutral manner to facilitate, and not create unnecessary obstacles to, the flow of trade. As this Committee is fully aware, the WTO Agreement on Rules of Origin imposes certain affirmative obligations on the United States and the other WTO members during the current "transition period," which will continue until such time as the WTO work program is completed. During the transition period, WTO member countries are required by Articles 2(b) and 2(c) of the Agreement to ensure that:

> (1) notwithstanding the measure or instrument of commercial policy to which they are linked, their rules of origin are not used as instruments to pursue trade objectives directly or indirectly; and
>
> (2) rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade.

The treatment of mixtures and composite goods under the Part 102 rules (and specifically under § 102.11(c)) violates both these disciplines and constitutes a failure of the United States to fulfill its affirmative obligations under the Agreement on Rules of Origin.

As a marking rule, the Part 102 rule on mixtures and composite goods imposes significant new burdens on producers using foreign-origin materials and thereby constitutes a non-tariff barrier and a disincentive to use foreign materials in manufacturing or processing. The rule also is contrary to the purpose of GATT Article IX(2), which is intended to minimize the "difficulties and inconveniences which such measures [*i.e.*, laws and regulations relating to marks of origin] may cause to the commerce and industry of exporting countries."

Frozen produce manufacturers such as Pillsbury are prejudiced by a country of origin marking rule requiring disclosure of the countries of origin of the various significant ingredients used in a mixture. Like other producers of frozen mixed vegetable products, Pillsbury must obtain some ingredients from different source countries. Because of seasonal factors, unexpected events such as floods and droughts, and other supply variables that affect most agricultural commodities, Pillsbury could be faced with the need to change the source country of some vegetable ingredients on short notice, throughout a given year. For example, with respect to a particular mixture containing four different vegetables, for each of which the source country changes only once per year, Pillsbury would need to maintain sixteen different labels in its inventory at all times. It is commercially impracticable for a company such as Pillsbury to interrupt its production to develop new labels each time it changes the source country of an ingredient in a vegetable mixture. Properly applied, the substantial transformation principle avoids these problems in the marking context. Country of origin marking rules should be interpreted to require disclosure to the ultimate purchaser of the country of origin of the finished product, not disclosure of the various countries of origin of the ingredients incorporated therein, no one of which imparts its essential character to the finished good.

Moreover, the country of origin labeling required by the current Customs interpretation on mixtures serves no legitimate consumer need. Pillsbury strives to fulfill consumer expectations and accordingly pays close attention to the interests and concerns that consumers express. With respect to frozen mixed vegetable products, Pillsbury's experience is that consumers are interested in taste, price, nutritional information, ease of preparation, whether or not the contents match the picture on the label, and the consistency of the product from purchase to purchase. Consumers have not expressed an interest in receiving country of origin information on the ingredients used in making these products. Pillsbury believes that the Customs interpretation of the marking requirement for frozen vegetable mixtures is an example of overregulation: the costs and burdens it is imposing on the industry are not justified by any appreciable benefit to the consumer.

The current rule in § 102.11(b) is a disincentive to the use of foreign ingredients in frozen vegetable mixtures. As such, the rule is a non-tariff barrier directed against the use of foreign-sourced produce for use as ingredients in the manufacturing of products in the United States. The Agreement on Rules of Origin, in Article 2(b), explicitly disallows this practice. Moreover, because Customs is misapplying the country of origin marking requirement to require affected U.S. manufacturers, such as Pillsbury, to change product labeling each time sourcing of an ingredient changes, Customs has impermissibly allowed the marking requirement to influence sourcing decisions. Pillsbury can attest that on one or more occasions, the ingredient labeling requirement has caused it to decline to source a particular ingredient from a U.S. grower because of the disruption that would occur in Pillsbury's production of labels. In brief, Customs has established a non-preferential rule of origin that creates restrictive, distorting, and disruptive effects on international trade, in violation of the requirement in Article 2(c) of the Agreement.

As applied for general non-preferential tariff purposes, the Part 102 rule on mixtures and composite goods is unworkable and disruptive from the standpoint of the entry process, assessment of duty, and valuation. For these

general tariff purposes, a good should have only one country of origin, as a matter of precedent and practicality of application. However, if applied as written, § 102.11(c) would require in some cases that different materials or ingredients be assessed under different tariff rates, and be subjected to separate valuation, depending on the various countries of origin. For example, a good imported into the United States that contains an ingredient or material from a Column 2 country would necessitate a separate valuation and duty assessment for that ingredient. Other countries attempting to apply a similar rule under their own customs procedures would encounter the same administrative impracticality.

To meet its obligations under the Agreement on Rules of Origin, the United States must evaluate its current rules of origin for conformity with the principles of the Uruguay Round Agreement on Rules of Origin (a process now underway in the ITC investigation). Accordingly, this Committee should recognize that the current § 102.11(c) rule, which results in multiple countries of origin for tariff purposes, not only is inconsistent with those principles but also is unsuitable as a basis for international harmonization.

C. Inconsistency with Section 304 of the Tariff Act of 1930, as Amended

The current Customs Part 102 rules are inconsistent with Section 304 of the Tariff Act of 1930, as amended (19 U.S.C. § 1304), in the treatment of mixtures and composite goods for which no foreign ingredient imparts the essential character.

Section 304 does *not* provide Treasury and Customs the authority to issue regulations requiring country of origin marking for ingredients used in producing finished goods. Instead, Section 304 provides, with certain exceptions, that:

> every *article* of foreign origin (or its container . . .) imported into the United States shall be marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the *article* (or container) will permit in such a manner as to indicate to an ultimate purchaser in the United States the English name of *the country of origin* of *the article.*

19 U.S.C. 1304(a) (emphasis added). The plain meaning of the statutory language is that an article of foreign origin, or its container, must be marked to indicate its own country of origin. There is no requirement in Section 304 to mark a finished good to inform the ultimate purchaser of the countries of origin of the various foreign materials used to make the good.

Pillsbury, as a major manufacturer of frozen vegetable mixes under the Green Giant® brand, is particularly concerned about the adverse effect that the current Part 102 rules on mixtures are having and will have on frozen mixed vegetable products. Pillsbury believes that current § 102.11(c) is a misguided attempt to "codify" a 1993 private letter ruling that Customs issued to Pillsbury requiring Pillsbury to label a line of its frozen mixed vegetable side dishes to display the countries of origin of foreign ingredients. HRL 735085 (June 4, 1993). For the reasons discussed in Pillsbury's July 5, 1994 comment submission to Customs and summarized herein, the Customs ruling letter is incorrect under Section 304 of the Tariff Act and disregards long-standing principles of substantial transformation.

As a private letter ruling, HRL 735085 does not establish a rule of general applicability and is not precedential. Pillsbury believes the holding of this ruling, which is contrary to law and established precedent, should not be

incorporated into the Part 102 rules. As Customs itself has recognized, the purpose of adopting the Part 102 rules is "to add more certainty and uniformity to the substantial transformation test." 60 Fed. Reg. at 22314 (quoting *Target Sportswear Inc. v. United States*, Slip Op. 95-7 (Ct. Int'l Trade 1995)). The codifying of HRL 735085 in the Part 102 rules, rather than adding certainty and uniformity based on established precedents, is an unwarranted attempt to establish a new rule of law that is at odds with established precedent. Therefore, the position of HRL 735085 should not be included in the Part 102 rules and should not be adopted in any U.S. position for international harmonization of rules of origin.

In discussions with Pillsbury, Customs officials have expressed their view that a product made in the United States and consisting of a mixture of frozen vegetables, some of which are imported but none of which imparts the essential character to the finished good, is not an "article" for purposes of Section 304 but instead is a collection of different articles, each of which, in Customs' view, is subject individually to the Section 304 marking requirement. This position, Pillsbury submits, is unprecedented and contrary to the plain meaning of Section 304, under which the issue is whether the finished article is a new and different article of commerce when compared to the imported article.

Customs' contention that a frozen side dish consisting of a mixture of different vegetables is a collection of different articles for marking purposes ignores the obvious fact that the product is a *mixture*. As a matter of definition, a single, packaged good consisting of a mixture of ingredients is not a collection of different articles. If such an article does not have the essential character of any one ingredient, logically it must have its own essential character and its own commercial identity. It is contrary to Section 304 and the long-standing principles of substantial transformation to treat such a good as if it were a collection of different articles put up in a set.

The serious problems caused by the current Customs treatment of mixtures and composite goods are not confined to mixed vegetable products. For example, the tariff change rules in § 102.20 do not recognize a substantial transformation in the production of mixed fruit and nut products of Chapter 20. Accordingly, under the Part 102 rules the manufacturing of products consisting of a variety of prepared fruits, prepared nuts, or combinations of prepared fruits and prepared nuts, would not confer origin in the country of manufacture. Instead, such products would have multiple, and possibly quite numerous, countries of origin, based on their various ingredients. Pillsbury believes that the same difficulties would arise for products consisting of mixtures of cereals under heading 19.04 or of mixtures of snack foods under heading 19.05.

D. Pillsbury's Suggested Changes to the Part 102 Rules

In comments submitted to the Customs Service on July 5, 1994, Pillsbury recommended specific language changes that would bring the Part 102 rules, and specifically § 102.11(c), into conformity with Section 304 of the Tariff Act and the substantial transformation principle. These changes are summarized briefly below.

Pillsbury believes § 102.11(c) should be amended to limit its scope to goods put up in sets for retail sale, and to clarify the particular way that the subsection would apply to sets. Pillsbury suggests the following language:

§ 102.11 General Rules

> (c) Where the country of origin cannot be determined under paragraph (a) or (b) and the good is specifically described in the Harmonized System as a set ~~or mixture~~, or classified as a set, ~~mixture or composite good~~ pursuant to General Rule of

> Interpretation 3, the country of origin of the ~~goodset~~ is the country or countries of origin of all materials that merit equal consideration ~~for determiningas~~ materials significant to the ~~essential~~ character or use of the ~~goodset~~.

The effect of this change is that mixtures and composite goods for which no single ingredient imparts the essential character would have the origin of the country in which the various ingredients were combined, pursuant to § 102.11(d). In this way, the result would be consistent with that reached under the substantial transformation principle.

Pillsbury also recommends a change to the tariff change rule in § 102.20 applicable to frozen vegetable mixtures, so that the origin of frozen mixed vegetable products may be determined without resort to the more general rules under § 102.11(c) and (d). The recommended change is as follows:

> 07.10 A change to heading 07.10 from any other chapter, or a change to subheading 0710.90 from any other subheading, provided that no single vegetable ingredient of foreign origin constitutes 75 percent or more of the product by net weight.

Under this revision, instances in which 75 percent or more of the net weight of a mixed frozen vegetable product is comprised of a single foreign material will be determined under the essential character principle of § 102.11(b).

II. Deference to the Substantial Transformation Principle during the Transition Period

Pillsbury believes it has been adversely affected by the Customs Service change in position pertaining to rules of origin for products consisting of frozen vegetable mixtures. Pillsbury is unaware of any instance prior to the June 1993 issuance of HRL 735085 in which Customs held that producing a frozen vegetable mixture by combining different vegetable ingredients was *not* a substantial transformation of the individual ingredients resulting in a new and different article of commerce.

To the contrary, Customs itself has recognized that an imported ingredient that does not impart the essential character to the finished product is substantially transformed when combined with other ingredients. *See, e.g.*, C.S.D. 84-50, 18 Cust. Bull 964 (Nov. 5, 1983) (mixing different fertilizers to form a precise blend results in new and different article of commerce). Moreover, Customs earlier had approved a manufacturing drawback contract for Pillsbury's production of "frozen assorted vegetables and side dishes," implicitly concluding (as then required for manufacturing drawback) that the imported broccoli, cauliflower, spinach, and Brussels sprouts involved in the drawback proposal are substantially transformed in the manufacturing of the frozen assorted vegetables and side dishes. T.D. 89-29, 23 Cust. B. & Dec. 195 (1989).

Pillsbury believes it is particularly important, during the transition period, that Pillsbury and other companies similarly situated not be unfairly prejudiced by the Customs Service's imposition of unprecedented new rules of origin. For this reason, Pillsbury recommends, as discussed above, that Treasury and Customs bring the existing Part 102 rules into conformity with the substantial transformation principle. Additionally, during the time necessary to accomplish this task, Customs should allow affected companies to rely on the substantial transformation principle for country of origin marking and general tariff purposes. Specifically, Customs should amend the interim Part 102 rules to allow affected

parties the option of treating a good as the product of the last country in which the good underwent a substantial transformation, as determined under existing substantial transformation principles and precedents.

III. The Treasury Department and Customs Service Should Defer Issuance of General Non-Preferential Origin Rules Pending the Implementation of the Results of the WTO Work Program

Pillsbury believes Treasury and Customs should defer any action to promulgate the non-NAFTA, non-preferential rules of origin that it proposed last year. 59 Fed. Reg. 141 (January 3, 1994). Pillsbury sees no compelling need for any such action at this time. Any changes to the origin rules resulting from the rulemaking Customs initiated in 1994 would have to be considered temporary because of the ongoing WTO work program to develop internationally-harmonized origin rules. This international effort, undertaken pursuant to the Uruguay Round Agreement on Rules of Origin, may produce rules or origin that differ considerably from the current Part 102 rules developed by Customs. Accordingly, Customs should not take any action to promulgate non-NAFTA, nonpreferential rules of origin until the WTO exercise is complete and the United States takes action to implement the results of that exercise. Were Customs now to proceed to promulgate final rules, affected companies may be required to make labeling revisions twice--first to comply with the new rules, and again when it is necessary to change those rules to achieve conformity with the internationally harmonized rules developed under the Uruguay Round Agreement on Rules of Origin.

Deferral of action to finalize the Part 102 rules pending completion of the WTO exercise on rules of origin also is warranted because of the recently-announced origin rule investigation by the U.S. International Trade Commission ("ITC"). Investigation No. 332-360, 60 Fed. Reg. 19605 (Apr. 19, 1995). This investigation, initiated pursuant to Section 332(g) of the Tariff Act of 1930 at the request of the U.S. Trade Representative, is a critical part of the effort to fulfill U.S. responsibilities under the Agreement on Rules of Origin. As a starting point, that investigation will examine the current Part 102 rules.

In announcing the Section 332 investigation, the ITC stated its intention to address the sufficiency of the current Part 102 rules as a means of determining when substantial transformation has occurred. 60 Fed. Reg. 19605, 19606. The ITC stated that it will seek to identify instances in which the Part 102 rules may lead to different results than the substantial transformation standard, as the latter test traditionally has been applied by Customs and the courts in determining origin for nonpreferential purposes. *Id.* Also, the ITC is interested in private sector views on the suitability of the Part 102 rules as a basis for determining the origin of U.S. exports. *Id.*

Pillsbury submits that Customs should not be taking action to finalize the general nonpreferential rules of origin, which Customs to date has issued only in proposed form, at the very time another U.S. trade agency is investigating the sufficiency of those same rules. Sound administrative practice would dictate that Customs defer any such action until the completion of the ITC investigation and the larger WTO origin rule exercise of which it is a part.

IV. The Treasury Department Should Institute a Moratorium on Any New Country of Origin Regulations that Impose New Marking or Labeling Requirements

Changes in rules of origin can require affected companies, such as Pillsbury, to incur significant costs and burdens. This is particularly true in the country of origin marking context, in which origin rule changes frequently require companies to change product marking or labeling. Because of this concern, Pillsbury believes the Treasury Department should observe a moratorium on any further country of origin regulations that require affected industries to incur

relabeling or other compliance costs. The moratorium should continue until the United States implements the final results of the WTO work program.

As noted previously, certain changes to the interim Part 102 rules are needed at this time: These rules should be brought into conformity with the substantial transformation principle, and during the time necessary to accomplish this task companies should have the option of treating goods as having the origin of the last country in which they underwent processing resulting in a substantial transformation, according to established principles and precedents. Because such changes would be at the option of the affected party, they would not impose any new or additional regulatory compliance burdens and not be affected by the moratorium. On the other hand, any changes in the Part 102 rules that would result in compliance burden should be deferred pending implementation of the results of the WTO work program to harmonize origin rules on an international basis.

Pillsbury believes the moratorium should extend to any regulations imposing new country of origin marking requirements requiring companies to change their existing labeling or marking practices. Even though such regulations might not, as a technical matter, constitute changes in rules of origin, they should be deferred so that companies are not forced to change their labels, only to be faced with the requirement of changing labels again when the WTO work program is completed.

As an example, Customs earlier this year issued an advance notice of proposed rulemaking on the issue whether new regulations should be developed for the country of origin marking of frozen produce products. 60 Fed. Reg. 6464 (February 2, 1995). In comments submitted in response to the advance notice of proposed rulemaking, Pillsbury stated its position that new, special rules for the method and location of marking of frozen produce products are unnecessary. Pillsbury continues to take the position that there is no need or justification for these rules. Nevertheless, should Customs decide to develop any such rules, Pillsbury urges Customs, as a matter of good regulatory practice and avoidance of unnecessary regulatory burden, to avoid any implementation schedule that would require affected manufacturers to change labels more than once.

* * *

Pillsbury appreciates the opportunity to present our views on this important international trade issue. We shall be pleased to continue to assist the Committee in any way possible as it continues its work on this topic.

Chairman CRANE. Thank you, Ms. Kline.

Ms. Guarino, in your statement you suggest that Customs should formulate a more flexible rule for country of origin marking requirements for commingled fungible goods. Do you have any specific proposal in mind?

Ms. GUARINO. Not as GMA, we do not at this point.

Chairman CRANE. Ms. Kline, do you?

Ms. KLINE. Not at this time.

Chairman CRANE. Mr. Stanceu.

Mr. STANCEU. Yes, Mr. Chairman, we would take the position that the industry really does need a flexible rule for commingled fungible goods that is at least as flexible as the rules that Customs has applied to a few products such as fruit juices, the rule that they have called the major supplier marking rule, and that is a rule whereby a company may list up to 10 countries, provided that 75 percent of the content of a particular lot is accounted for by the countries that are listed on the label.

This is a good start. We feel that this is a promising concept, because it provides flexibility, but we think there are some technical problems with the major supplier marking rule, specifically the very narrow definition that has been given to the word "lot," such that it seems to require changes in the label a bit too often. We think that some technical tweaking of this rule or some variant of that possibly could serve the industry better.

Also, there may be cases where hard and fast rules such as the major supplier marking rule simply will not meet the needs of a particular industry that has complex sourcing patterns. In that case, we would also advocate an approach where there would be some flexibility for case-by-case exceptions.

Chairman CRANE. Do you have any thoughts on that subject, Mr. Folkerts?

Mr. FOLKERTS. No, I do not, Mr. Chairman, except to say that I am not aware that we would have any disagreement with the recommendations set forth by Mr. Stanceu, and we would appreciate the opportunity to review that and get back to you on the record.

Chairman CRANE. Thank you.

Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

Ms. Guarino, I was looking for your testimony, because I think you were the most irritated on the whole panel. It seems like you believe Customs is just out to get American industry and that they are just going out of their way to make life just terrible for you.

Being new on this committee, if I was to introduce a bill just to repeal section 304, since I was not here when they enacted it, where would you think you and I would have the most problem if we just repealed section 304?

Ms. GUARINO. Frankly, Mr. Rangel, GMA has had limited involvement as an association with Customs issues and we were in particular involved in the litigation that——

Mr. RANGEL. Then you and I are in the same boat. I need some help from somebody that——

Ms. GUARINO. Well, the front panel disclosure interpretation that was given——

Mr. RANGEL. I said if I move to strike all of that, you say it is vegetables, take my word for it, that is it. Now, what is the problem? Somebody is going to be on a different panel. Who would be here attacking you and me?

Ms. GUARINO. From the industry? I am not aware——

Mr. RANGEL. From anything. Why do you think section 304 is there? They want to know where the beans come from. I do not see the big problem in saying they come from Europe, but obviously Customs has a different problem. They want specifics and you do not like it. I say that I agree with you and I say you do not have to say where they come from.

Ms. GUARINO. No, actually we do not have a problem at all with the basic country of origin marking requirement. It is the way that requirement was interpreted in particular in recent years in the context of some frozen products.

Mr. RANGEL. I am saying that if I remove that so that you no longer are angry with anybody, who would be angry with us? It must be there for somebody besides Customs.

Ms. GUARINO. Frankly, Mr. Rangel, I am here speaking on behalf of GMA and I cannot answer your question.

Mr. RANGEL. Could anyone here on the panel find out any reason why we should have section 304 in any form that you would find comfortable to do your business?

Mr. STANCEU. Could I speak to that for 1 minute, please, sir?

Mr. RANGEL. Would you.

Mr. STANCEU. Thank you, Congressman. The section 304 requirement in its current form was enacted in the Tariff Act of 1930.

Mr. RANGEL. I want to bring it up to 1995, to today. It is there.

Mr. STANCEU. Right.

Mr. RANGEL. Now, if I remove it or have a bill to remove it, I am going to get a lot of mail from whom?

Mr. STANCEU. I would think that many domestic producers of many kinds of goods would want to have the country of origin marking requirement in general form maintained.

Mr. RANGEL. Suppose you say "Made in the U.S.A.," if it is made in the U.S.A.? You do not see that then.

Mr. STANCEU. Right, and that, of course——

Mr. RANGEL. Do you have any problem with that?

Mr. STANCEU. No, I do not. In fact, as——

Mr. RANGEL. Well, who would have a problem with that? Who cares whether the beans came from Korea or Thailand?

Mr. STANCEU. I would suggest, Congressman, that the problems that we are seeing do not really stem from the inherent language of section 304, that they stem from a very overly rigid interpretation of the substantial transformation principle——

Mr. RANGEL. Ms. Kline, you have vegetables and you have a problem in that you cannot find which beans and what season came from what country, and so you cannot keep up because they are perishable goods and you have to have labels every 2 weeks or something, right?

Ms. KLINE. Yes.

Mr. RANGEL. Now, if I say you do not have to do that, can you not suggest who you and I have offended besides Customs?

Ms. KLINE. The major screen that Pillsbury as a company uses to understand these things is the consumer and, as I said before——

Mr. RANGEL. Now we are getting close. The consumer would care where the beans came from?

Ms. KLINE. The consumer in our research, we found that the consumer would not care, that country of origin is not a material factor.

Mr. RANGEL. Do we have that they can come from anywhere except Cuba or any violators? [Laughter.]

Listen, there must be a good reason for it or the Congress never would have gotten involved in this. [Laughter.]

I am going to take a serious look at it, but I cannot do it unless I have the cooperation of the American firms that believe that their work is being impeded, productivity is being impeded, in competition and therefore American jobs. So we cannot have this idea that this is the problem, but I do not have an answer. Clearly, if it is a consumer problem, you have to come up as though I am the consumer and say this is what I am prepared to do for you.

I have yet to understand, even though I am certain after this hearing is over someone will try to get me to understand, as to how important it is what country it is, even though I wish we paid more attention to what ingredients are in the can. I have had cans which say "made of meat products, pork, chicken," whatever we could find, we threw it together and that is what you are getting. I think that is more important than what country it came from.

But think about it and, Mr. Chairman, you and I will work together and try to make certain that, under new administration, what is not needed we will not have.

Chairman CRANE. It sounds good to me, Mr. Rangel.

Let me ask you one quick question, though. If you go to the supermarket and want Idaho potatoes and you find out they were actually grown in New York State, would you not be offended?

Mr. RANGEL. It depends on the price, obviously, and which ones were cheaper. [Laughter.]

Chairman CRANE. All right. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Mr. Stanceu, under the current Customs rules, is it possible that a product that has a mixture of ingredients such as vegetables or fruits could be required to be marked for multiple countries of origin?

Mr. STANCEU. Yes, Congressman, it is. In fact, that is specifically the result with respect to mixtures of frozen vegetables. These are entrees and side dishes that are prepared for a specific market niche. They have a distinct commercial identity. As the Customs Service would concede, that commercial identity is not imparted by any specific foreign ingredient.

In other words, these products are new and a different article of commerce by definition. Yet, the Customs Service has held that we must mark these articles under these new rules for every significant ingredient that merits equal consideration for determining the essential character, to use their words, and the result is that you have to list on the label the countries of origin of all of the foreign ingredients in a vegetable mixture.

Mr. PAYNE. But under the old rules, it would have been one country?

Mr. STANCEU. Yes, that is right, under the old rules, the old traditional rule of substantial transformation, which the courts have long defined as a change in the name, character, or use of a product that results in a new and different article of commerce. Under that test, in the plain meaning of the words in that test, you would have a new and different article of commerce, because you would have a change in character.

You would also have a change in name and a change in use. But even Customs would admit, and in fact, their rule specifically recognizes, that the individual imported ingredient has a different essential character from the finished product, and we know they recognize that because they apply the rule only where the individual foreign ingredient fails to impart the essential character to the finished good.

We simply observe that, by definition, you have to have substantial transformation of the individual foreign ingredients, all of which are different products, where none of those individual foreign ingredients impart the essential character to the finished product. You would have to have a new and different article and it would be an article of the country where the good was combined and formed into a new and different article of commerce.

Mr. PAYNE. Would it be true that one of the solutions to this would be to maintain the status quo?

Mr. STANCEU. There are several problems with that, and the main problem, Congressman, is that the current part 201 rules which have been proposed by Customs to apply to all goods for nonpreferential purposes in international trade, Customs has now proposed to apply those rules outside the NAFTA context. Currently, they apply only to goods in the NAFTA context, in other words, goods that have some ingredients from Canada or Mexico in them, so that you have now two rules, in effect.

You have the traditional substantial transformation rule, which would say that you have a substantial transformation when you combine all of these things, and that would apply unless you have a NAFTA component in there, Canada or Mexico. If you have a NAFTA component, Canada or Mexico, then the new rule would apply and you would have to label this product for all the different countries of all the different source ingredients.

So we are already subject to the new rule in the NAFTA context. We believe that this should not be extended beyond the NAFTA context and that the NAFTA rules, the current part 102 rules, should be amended at once to correct this inconsistency with longstanding principles of law.

Mr. PAYNE. One last question. You said that the way to solve this is to do what they have done with fruit juices. What is the difference between the way the frozen products are being treated and fruit juices are being treated?

Mr. STANCEU. Fruit juices are subject to a new and special rule and in our written comments we have suggested a technical change to the fruit juice rule, as well. If my memory serves, there is a rule that no more than 60 percent of the finished product can come from one single source country, and no more than 60 percent of the fin-

ished product can be one fruit juice ingredient. In other words, you would have to meet both of those rules to have a new and different article of commerce.

To the extent that the fruit juice rule recognizes that combining different juices into a new juice, that that is a substantial transformation, we agree with it. To the extent that it would also say that a product is not substantially transformed when different juices are combined in certain cases, we do not agree with it, and that is what our technical change is designed to fix.

Mr. PAYNE. Thank you, Mr. Stanceu.

Thank you very much, Mr. Chairman.

Chairman CRANE. Let me thank all of you who appeared on this panel. We appreciate your coming before us and giving us your insight.

With that, I would like to summon our final panel, Robert Hall III, John Pellegrini, George Morgan, Charles Hansen, and Carlos Moore.

Mr. Hall, will you open up.

STATEMENT OF ROBERT P. HALL III, VICE PRESIDENT AND GOVERNMENT AFFAIRS COUNSEL, NATIONAL RETAIL FEDERATION

Mr. HALL. Thank you, Mr. Chairman, Mr. Rangel, and Mr. Payne.

I am Robert Hall, vice president and government affairs counsel of the National Retail Federation, the Federation, the Nation's largest and oldest retail trade association. I am very pleased this afternoon to have the opportunity to appear before you to discuss the impact on the retail industry of various efforts to revise or change U.S. rules of origin.

U.S. textile and apparel rules of origin are a patchwork of complicated and differing requirements that increase the costs of importing and impose an ever-more cumbersome burden on U.S. Customs and on the U.S. consumer. The United States has one rule for trade with Mexico and Canada, another rule governing trade with all other countries, special rules for goods imported under the 807 and 807A outward processing programs, and, after 1996, still yet another rule governing trade with Israel. Clearly, there is a great need for harmonization, not just among WTO trading partners, but within the United States itself.

With steady determination, the United States has set out on a number of fronts to promote trade, investment, and economic growth by liberalizing U.S. and foreign trade barriers—only to see many of these benefits evaporate as the details of "liberalization" are drafted. The devil is in the details. These details are the rules of origin that define which products will qualify for trade liberalization.

Restrictive rules of origin narrow, complicate, or erase the benefits of trade agreements affecting apparel trade, including the NAFTA and, most recently, the GATT Agreement. These rule changes should not be taken lightly, and changes to existing rules, upon which longstanding sourcing relationships have been built, should be undertaken carefully and for sound commercial, and not political reasons.

Let us turn to those two recent examples. One purpose for liberalizing U.S.-Mexico textile and apparel trade was to provide sufficient incentive, in the form of tariff reductions and immediate quota eliminations, for U.S. importers to shift sourcing to the region from countries outside North America. However, because of the restrictive "yarn forward" rule of origin change, companies simply did not do that and, as a result, the NAFTA benefits have not been realized.

Therefore, when you are considering rules of origin for future free trade agreements, policymakers should carefully review the NAFTA experience. If the NAFTA textile and apparel rules of origin are to be applied to other trading partners, for example, the Caribbean Basin, care must be taken to ensure that the special safeguards built into the NAFTA also convey to these new agreements.

Now let's turn to last year's GATT Agreement. Congress approved legislation to implement the Uruguay Round GATT Agreement which will gradually phase out longstanding U.S. quotas on textile and apparel products. However, included in that implementing legislation was an unnecessary and wholly unrelated requirement that the United States change its rules of origin applying to textile and apparel products on July 1, 1996. This rule of origin change will disrupt trade and render numerous textile and apparel product quota levels inadequate, complicating apparel sourcing and increasing the cost of importing, erasing the one clear benefit of the agreement's textile and apparel provisions: more flexible sourcing alternatives and, consequently, lower prices for consumers.

We have filed with Customs our views on these several problems that we have found inherent in the draft rules. We found that difficulties will arise from the current date of export effective date, the definition of "knit-to-shape," the scope of textile and apparel products subject to the rules, the impact of the rules on insular possessions like the Mariana Islands and Saipan, the lack of any definition or guidance on the terms "most important assembly," and "least . . . important assembly." Each of these problems must be rectified by the final rules, and clearly it will take the interagency process some time to do that.

Given the number of rules that are applicable just to textile and apparel trade, the 3-year effort of the WTO Agreement on rules of origin to harmonize the international rules of origin is timely. It makes little sense to change these rules on July 1, 1996, and again in just a few years as a result of the international trade harmonization.

Arguments that a U.S. change toward assembly now merely advances the international harmonization efforts will prejudge the outcome of the international talks. It is clear that all parties affected by the change, including the U.S. Government, could use more time to prepare. The 18 months provided by the Uruguay round legislation is wholly inadequate.

The U.S. Customs Service now recognizes it could not publish final textile and apparel rules of origin by its July 1, 1995, statutory deadline. In fact, they have missed that deadline. It took the interagency process almost twice as long as the time allotted to publish draft rules for industry comment, and it is certain to re-

quire just as long to fully consider all of the comments received and to revise the draft rules accordingly.

Moreover, the U.S. Office of Trade Representative will not be able to quickly negotiate the quota levels for all those countries impacted. Many retailers will now have to place orders very soon for final delivery of merchandise after July 1, 1996, and it appears we will not know for certain until the fall at the earliest what the final rules will be and which foreign supplier will have sufficient quota. This uncertainty is disrupting our businesses and will ultimately mean higher prices for U.S. consumers.

In conclusion, the Federation supports changes to U.S. rules of origin that make those rules clearer, more predictable, and less complicated. While the current system is by no means flawless, the Federation opposes changes to the current system that are insensitive to the impact on trade and to the time requirements of not only importers and foreign suppliers to adjust, but also the U.S. Government to fully and thoughtfully consider the potential impact of changes implemented on July 1, 1996, or at any time thereafter.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF ROBERT P. HALL III
VICE PRESIDENT AND GOVERNMENT AFFAIRS COUNSEL
NATIONAL RETAIL FEDERATION

I. Introduction

Good afternoon. I am Robert Hall, Vice President, Government Affairs Counsel, at the National Retail Federation (the "Federation"). I am very pleased to have the opportunity to appear before you today to discuss the impact on the retail industry of various efforts to revise U.S. rules of origin.

The Federation is the nation's largest trade group which speaks for the retail industry. It represents the entire spectrum of retailing, including several dozen national retail associations and all 50 state retail associations. The Federation's membership represents an industry that encompasses over 1.5 million retail establishments, employs more than 20 million people, and registered sales in excess of $2 trillion in 1994.

U.S. textile and apparel rules of origin are a patchwork of complicated and differing requirements that increase the costs of importing and impose an ever-more cumbersome burden on U.S. Customs. The United States has one rule for trade with Mexico and Canada, another rule governing trade with all other countries, special rules for goods imported under the "807" and "807A" outward processing programs, and, after 1996, still another rule governing trade with Israel. Clearly, there is a great need for harmonization, not just among World Trade Organization (WTO) trading partners, but within the United States itself.

II. Rules of Origin Can Erase the Benefits of Trade Agreements

With steady determination, the United States has set out on a number of fronts to promote trade, investment and economic growth by liberalizing U.S. and foreign trade barriers -- only to see many of those benefits evaporate as the details of that "liberalization" are drafted. These details are the rules of origin that define which products will qualify for trade liberalization. Restrictive rules of origin narrow, complicate, or even erase the benefits of trade agreements affecting apparel trade, including the North American Free Trade Agreement and, most recently, the Uruguay Round Agreement implementing legislation. Thus, these rules should not be taken lightly, and changes to existing rules, upon which long-standing sourcing relationships have been built, should be undertaken carefully, and for sound commercial, not political, reasons.

A. NAFTA Textile/Apparel Rules of Origin

One purpose for liberalizing U.S.-Mexico textile and apparel trade was to provide sufficient incentive, in the form of tariff reductions and immediate quota eliminations, for U.S. importers to shift sourcing to the region from countries outside North America. But then negotiators devised a complicated "yarn forward" rule of origin to prescribe which textile and apparel products would receive NAFTA's tariff and quota benefits. This rule of origin generally requires the beneficiary apparel products to be made from both yarn and fabric that was made in North America.

The effect of this rule has been to limit the degree to which retailers and importers could shift sourcing from non-NAFTA countries to North America. In many cases, the yarn or fabric required to make an apparel product is not available from North American suppliers, so U.S. importers must continue to source that apparel product from non-North American suppliers.[1] As a result, the NAFTA had to provide for "tariff preference levels" -- fixed quantities of textile and apparel goods that do not meet the "yarn forward" rule of origin but may nevertheless benefit from NAFTA's tariff reductions for these products.

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[1] Had the rule of origin been less restrictive, importers could have arranged for the requisite fabric to be shipped to Mexico and made into an apparel product there, for later importation into the United States. Alternatively, U.S. importers could have brought the foreign fabric into the United States, for manufacture into an apparel product in the United States and exportation to Canada.

In addition, it must be remembered that the more complicated and restrictive the rule of origin, the greater the record-keeping requirements for importers and manufacturers. At some point, the burden becomes too great, both in terms of expense and risk of error. NAFTA then is no longer a commercially viable benefit, and sourcing from non-NAFTA suppliers continues.

Therefore, when considering rules of origin for future free trade agreements, policymakers should carefully review the NAFTA experience. If the NAFTA textile and apparel rules of origin are to be applied to other trading partners (e.g., countries in the Caribbean Basin) care must be taken to ensure that the special safeguards built into it (e.g., "tariff preference levels") also convey to these new agreements.

B. Uruguay Round Agreement Implementing Legislation

Most recently, Congress approved legislation to implement the Uruguay Round Agreement, which will gradually phase out long-standing U.S. quotas on textile and apparel products. However, included in the implementing legislation is a requirement -- wholly unrelated to any provision of the Agreement negotiated by the United States and its trading partners -- that the United States change its current rules of origin applying to textile and apparel imports on July 1, 1996.

This rule of origin change will disrupt trade and render numerous textile and apparel product quota levels inadequate.[2] It will complicate apparel sourcing, and increase the costs of importing erasing the one clear benefit of the Agreement's textile and apparel provisions: more flexible sourcing alternatives and, consequently, lower prices for consumers.

The Federation noted several problems inherent in the draft rules issued by Customs on May 23. These include difficulties that will arise from the current date-of-export effective date, the definition of "knit-to-shape," the scope of "textile and apparel" products subject to the rules, the impact of the rules on insular possessions, and the lack of any definition or guidance of the terms "most important assembly" and "last ... important assembly." Each of these problems must be rectified by the final rules. Clearly, it will take the inter-agency process some time to come to a resolution on these issues.

III. Harmonization Can Provide Commercial Clarity

Given the plethora of rules applicable just to textile and apparel trade, the three-year effort of the WTO Agreement on Rules of Origin (ARO) to harmonize international rules of origin is timely.

U.S. textile and apparel rules of origin should be modified only as part of the World Trade Organization rule-of-origin harmonization process. It makes little sense to change U.S. rules on July 1, 1996, and again in a few years as a result of the international harmonization effort. Arguments that a U.S. change toward assembly now merely advances the international harmonization effort prejudge the outcome of the international talks.

It is clear that all parties affected by the change, including the U.S. Government, could use more time to prepare. The 18 months provided by the Uruguay Round implementing legislation is wholly inadequate. The U.S. Customs Service now recognizes that it could not publish final textile and

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2 Current U.S. quota levels are the basis for all future quota levels over the next 10 years. The base quota levels are intimately related to trade patterns prevailing in 1994. That trade took place under a U.S. rule of origin that generally dictated that the country of origin is the country in which the apparel product was cut. The new rule of origin for apparel will generally dictate that the country of origin is that country where the apparel product is assembled. Therefore, many quota levels for particular countries will be too small after the United States adopts the new rule of origin.

apparel rules of origin by the July 1, 1995 statutory deadline. It took the inter-agency process almost twice as long as the time allotted to publish draft rules for industry comment, and it is certain to require just as long to fully consider all of the comments received, and revise the draft rules accordingly.[3]

Moreover, the Office of the U.S. Trade Representative will not be able to quickly negotiate new quota levels for countries adversely affected by the rule changes. Although the Statement of Administrative Action noted that USTR would begin necessary compensation consultations no later than July 31, 1995 with countries affected by the rule-of-origin change, it is not clear that those countries will know who they are, or to what extent they are affected by rules that will of necessity remain in draft form. Thus, retailers and importers will not know for some time what 1996 quota levels will be for suppliers with whom they currently do business.

Many retailers must soon place orders for final delivery of merchandise after July 1, 1996, and it appears that they will not know for certain until the Fall, at the earliest, what the final rules will be and which foreign supplier will have sufficient quota. In short, the three-year period for the WTO harmonization effort looks more and more reasonable as the most appropriate date to revise U.S. textile and apparel rules of origin.

IV. Conclusion

The Federation supports changes to U.S. rules of origin that make those rules clearer, more predictable, and less complicated. While the current system is by no means flawless, the Federation opposes changes to the current system that are insensitive to the impact on the trade, and to the time requirements of not only importers and foreign suppliers to adjust, but also of the U.S. Government to fully and thoughtfully consider the potential impacts of changes implemented -- on July 1, 1996, or any time thereafter.

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3 Customs was originally supposed to issue draft rules by March 8, 1995, 90 days after the Uruguay Round Agreement implementing legislation was enacted -- but the interagency process caused Customs to miss that deadline by a wide margin. Draft rules were not published for comment until May 23.

Chairman CRANE. Thank you, Mr. Hall.
Mr. Pellegrini.

STATEMENT OF JOHN PELLEGRINI, CUSTOMS COUNSEL, ON BEHALF OF UNITED STATES ASSOCIATION OF IMPORTERS OF TEXTILES AND APPAREL, NEW YORK, N.Y.

Mr. PELLEGRINI. Thank you, Mr. Chairman.

Mr. Chairman, Mr. Rangel, and Mr. Payne, my name is John Pellegrini. I am an attorney with the law firm of Ross & Hardies. I appear today as Customs counsel for USA–ITA, the United States Association of Importers of Textiles and Apparel. I am accompanied by Brenda Jacobs, who is with the law firm of Powell, Goldstein, Frazer & Murphy. Ms. Jacobs is Washington trade counsel to USA–ITA. The association has filed a long witness statement which we understand will be part of the record. My testimony this evening will be to highlight that written statement.

For some time, the members of USA–ITA have felt that textile rules of origin have been used as a means of restricting imports. But many of them are exporters also, and our testimony today is directed toward the overly restrictive effect textile rules of origin will have on the ability of U.S. companies to export and to compete in international markets.

Before getting to the export issue, it is important to point out that importers of textile and apparel are required to deal with three rules of origin, and these are just the nonpreference rules. The first rule is found in section 12.130 of the U.S. Customs Regulations. These regulations are based on the traditional rule of substantial transformation, with some specific guidelines designed to cover some of the more typical configurations of multicountry processing. These rules have been in effect since 1985, and because of a wide body of rulings and some court decisions, are fairly well understood by U.S. importers and their foreign suppliers.

The second rule of origin was proposed by the administration in January 1994 and a revised version was issued in May of this year. This is the rule which appears as annex 311 of the North American Free Trade Agreement. This rule adopts a very different approach than section 12.130 and is expressed in terms of changes in tariff classification. Under the annex 311 rules, the country of origin of some apparel was the place where the components are assembled, and for others as the place where the components are cut. The rules applicable to fabrics, apparel accessories, and home furnishings generally look to the place of manufacture as the origin of the product.

The third rule is found in section 334 of the Uruguay Round Agreements Act. Under this rule, the country of origin of virtually all apparel is the place of final assembly, the country of origin of fabric and of home furnishings and apparel accessories is the place where the fabric is formed. The annex 311 rules and the section 334 rules remain in proposed form.

Section 334 rules create quite a different approach to origin in the textile and apparel sector, particularly in fabrics, textile, home furnishings, and apparel accessories. This radical change is unnecessary and reflects the desires of narrow special interests. Worse, this rule will apply to goods imported on or after July 1, 1996. This

is the case, even though, as we speak, final regulations have not been promulgated.

Because the subcommittee's principal focus today is on the WTO work program on origin, the balance of our testimony addresses the U.S. negotiating position. Section 12.130 is not a practical basis for a U.S. position. It is far too subjective. The annex 311 rules are an improvement and, in general, USA–ITA supports rules based upon changes in tariff classification. There are, however, serious problems with the annex 311 rules as currently constituted. A few examples will illustrate our concerns.

Under annex 311, apparel accessories will be treated as a product of the country where they are manufactured, if certain processes take place in that country. This includes cutting and sewing on four sides. This ignores commercial reality.

Many of these products leave the so-called selvage side uncut and unsewn. Thus, under the annex 311 rules, the country of origin of these products would be the place where the fabric is formed. This will create problems for U.S. producers. If the annex 311 rules become the international standard, these producers will not be able to export their products as U.S. goods.

Exports will suffer. Products will be deemed to have originated in the country where the fabric is formed. This will create marketing problems, since part of the appeal of these products is the U.S.A. label. To the extent that quotas exist, the quotas will be those attributable to the country where the fabric is formed, not the United States. Firms and workers in the United States will suffer.

Other changes are necessary. Some annex 311 concepts are far too subjective to be useful in an international context. One example has to do with tailored garments where assembly constitutes the rule of origin. A tailored garment is defined in these rules as a type normally worn for business or social purposes, a noncasual garment when some degree of formality is required. These kinds of subjective comments will lead to confusion and controversy, because they are open to subjective interpretation. Their adoption at the international level could lead to abuse and permit discrimination against U.S. exports. These concepts vary from region to region, from country to country, and indeed perhaps from Customs official to Customs official.

While the annex 311 rules are not an ideal basis for an international standard, if they are amended to eliminate subjective elements and to realign the treatment of apparel accessories and home furnishings, they could serve as a solid basis for a balanced and responsible U.S. negotiating position.

On the other hand, U.S. exports will suffer markedly, if the section 334 rules are adopted at the international level. This is particularly the case for fabric converters and manufacturers of textile products other than apparel. Under the 334 rules, the country of origin of fabric is the place where the fabric is formed.

Subsequent processing, no matter how complex, will not change origin. The processing in the United States will not change origin. When exported, the goods will be subject to the same quota requirements as applied to products of the country where the fabric is formed. As a practical matter, this means that fabric importers

in the United States will not be able to export to places like the European Union, which have quotas.

The same thing applies to the origin of accessories and furnishing. Again, fabric is the place where these products are deemed to originate. Nothing you do in the United States can change the country of origin. It will make it impossible for these U.S. producers to export to other countries.

This is unusual. USA–ITA's views are shared by some domestic manufacturers. For example, the Schiffli Lace & Embroidery Manufacturers Association of North Bergen, N.J., in its comments to Customs on the proposed section 334 rules and the rules applicable to lace which say lace is made in the country where the basic fabric is formed, they characterize the rules as ludicrous. We must agree.

We support U.S. participation in the WTO negotiations. We support the purpose of these negotiations to develop and harmonize nonpreferential rules of origin designed to make origin determinations impartial, predictable, transparent, consistent, and neutral. This is a laudable goal. Unfortunately, the annex 311 rules as currently constituted, and certainly the 334 rules, are not suitable for this purpose.

We thank the subcommittee for holding these hearings now before either the annex 311 rules or the section 334 rules are finalized. The administration must pay careful attention to the impact that its position, if adopted at the international level, will have on U.S. exports. Exports should not be sacrificed for short-term goals on import restrictions.

Finally, in light of the serious problems created by the administration's delay in promulgating regulations implementing the section 334 rules, we urge this subcommittee to act to correct the inequities in section 334, particularly implementation based upon date of import, rather than date of export.

We thank the subcommittee and we are pleased to answer any questions you may have.

[The prepared statement follows:]

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U.S. RULES OF ORIGIN: U.S. ADMINISTRATION AND THE DEVELOPMENT OF A WORLD TRADE ORGANIZATION NEGOTIATING POSITION

Mr. Chairman and members of the Subcommittee, my name is John Pellegrini of Ross & Hardies. I appear today as Customs Counsel to the United States Association of Importers of Textiles and Apparel ("USA-ITA"). I am accompanied by Brenda Jacobs, of Powell, Goldstein, Frazer & Murphy, Washington Trade Counsel to USA-ITA.

USA-ITA is a voluntary association of 160 importers and retailers of textiles and apparel products as well as related service industries and transportation concerns. The importer and retailer members of USA-ITA import textiles and apparel products with a first cost in excess of $30 billion. USA-ITA appreciates the opportunity to testify on the rules of origin, a topic of great significance to its members.

We understand the Subcommittee's concern to be twofold: (1) administration of United States law for preferential and non-preferential rules of origin; and (2) the prospects of the World Trade Organization ("WTO") work program. USA-ITA's testimony addresses the administration of the existing rules, the proposed rules and the impact on United States exporters of adoption of United States rules by the WTO.

BACKGROUND

In order to understand USA-ITA's position on rules of origin, it is necessary to consider the impact that nonpreferential rules of origin have in the textile and apparel sector. Rules of origin are of vital importance to importers and exporters of textiles and apparel. Developed countries impose quantitative restrictions, or quotas, on textiles and apparel products from the Far East, Latin America, the Indian subcontinent, Africa - in short, virtually the entire world outside of the United States, Canada, the Nordic countries and the European Union. These restrictions are based upon origin, the determination of which varies from jurisdiction to jurisdiction. It is obvious that this is important to importers of textiles and apparel. It may be somewhat less obvious that these rules are of crucial importance to United States exporters of apparel and textile products.

At present, the rules of origin applicable to textile and apparel products imported into the United States are found at Section 12.130 of the Customs Regulations, 19 C.F.R. § 12.130 ("Section 12.130"). The Section 12.130 approach is founded in the traditional rules of substantial transformation, supplemented by a series of specific determinations on typical scenarios of production sharing. Generally, these rules are fairly well understood by importers and foreign manufacturers. These rules have been in place since 1984 and, by this time there is a substantial body of rulings and court decisions which flesh out the regulations.

In January of 1994, the Customs Service published a proposed set of rules which would replace Section 12.130 with rules based upon changes in tariff classification. These rules are found in Annex 311 of the North American Free Trade Agreement and are in place for trade among the United States, Canada and Mexico. Customs proposes to use these rules for trade with the balance of the world. These rules do not apply to tariff preferences and are limited to nonpreference matters, such as country-of-origin marking requirements and the application of quotas and other quantitative restrictions. We refer to these as the Annex 311 Rules. A new version of the Annex 311 Rules was published for comment on May 5, 1995, 60 Federal Register 22312. This version of the Annex 311 Rules is a marked improvement over the original proposal and is generally acceptable to USA-ITA. In large measure, these rules replicate the results that flow from the application of Section 12.130.

Yet another set of origin rules for textiles and apparel, those required by Section 334 of the Uruguay Round Agreements Act, was published for comment on May 23, 1995, 60

Federal Register 27378. We refer to these as the Section 334 Rules. The proposed Section 334 Rules will bring about a very substantial change in the way that the origin of textile and apparel products is determined. For apparel, the Section 334 Rules state that the place of assembly is the place of origin. Under existing rules, assembly is the place of origin for many products but the country where cutting of components takes place fixes the origin of others. Frankly, the simplicity of an assembly rule for apparel does have some appeal, but it also constitutes an unnecessary, radical, and politically-motivated change. These rules will apply to goods imported on or after July 1, 1996.

Moreover, the Section 334 Rules will have a very severe adverse consequence for importers of fabric, linens, apparel accessories and other made-up textile articles. There also will be very severe adverse consequences for many United States manufacturers of these products.

Importers of textiles and apparel are being forced to deal with three sets of rules in a very short period of time. This is an unfortunate fact and one which we hope that the Committee will remedy.

DISCUSSION

USA-ITA's testimony focuses on the WTO origin negotiations, and in particular on the usefulness of existing and proposed United States rules as a basis for the United States position in the negotiations. The Annex 311 Rules, with some modification, would provide the basis for a responsible position in the WTO negotiations, one which would protect legitimate United States interests in terms of domestic production, imports and exports. On the other hand, the Section 334 Rules would sacrifice United States exports.

Current Administration. The administration of the current rules of origin, those found at Section 12.130, generally is acceptable. As we note above, these rules have been in place for more than a decade and, by this time, they are well understood by importers and their suppliers. The administration of these rules is not a problem.

There are serious problems with the Section 334 Rules. Most significant among these is the fact that the effective date is July 1, 1996 and, unlike the U.S. quota program, which is administered by date of export from the country of origin, it applies to imports on and after that date. The implementation by date of import has become even more troublesome as a result of the slow pace of the Administration's development of the regulations implementing the Section 334 Rules. The Customs Service was supposed to have promulgated final regulations on or before July 1, 1995. It failed to meet that statutory deadline. It did not even issue the proposed regulations until late May, some three months later than promised in the Statement of Administrative Action, which accompanied the Uruguay Round Agreements Act. We suspect that happened in large part because the Administration was more concerned with moving toward finalizing the Annex 311 rules, in order to ensure that they are in place before the WTO work program begins, than with providing U.S. importers of textile and apparel products with the lead time intended by Congress for Section 334.

As a result, there are no final regulations and final regulations are not likely until late Summer. This is a serious deficiency. While Section 334 is explicit on many rules of origin, there are some areas, such as multi-country processing, which will require rulings in order to be fully understood. Customs cannot accept ruling requests, however, until the regulations are final. Since most rulings take 120 days, importers cannot expect to receive responses to ruling requests until early 1996. This is much too late for July 1996 importations which will have been purchased in late 1995. This is a very serious situation and will jeopardize the ability of importers to meet commitments to their customers. Origin governs admissibility. If the rule of origin is not clear, importers cannot be certain they have obtained the correct visa.

If they do not, their merchandise will not be allowed to enter the commerce of the United States. This uncertainty should not be allowed to continue.

WTO Negotiations. The U.S. position in the WTO must be carefully drawn to ensure the long-term competitiveness of U.S. companies in the global marketplace. USA-ITA believes that the Annex 311 Rules offer the most responsible basis for a United States position in the WTO origin negotiations.

Section 12.130. Although USA-ITA members have few complaints with Section 12.130, or its administration, these rules do not promise much as a basis for international rules. They are far too subjective.

Annex 311. USA-ITA does have a few problems with the Annex 311 rules. Although these rules generally replicate the results of Section 12.130, there are differences, many of which, if adopted at the international level, would hinder United States exports.

A few examples will illustrate this effect.

The rule for apparel accessories, such as scarves, handkerchiefs and the like, is that a change in classification from fabric to the completed product does not confer origin unless each of the following takes place in a single country: bleaching, dyeing, printing, cutting on all sides, and stitching.

The restrictive nature of this rule will adversely affect domestic employment by encouraging, even requiring, a shift to foreign production and, if adopted, at the international level, will have a serious adverse impact on exports of products manufactured in this country.

Handkerchiefs are made in the United States. For the most part, the fabric is produced in the People's Republic of China or Czechoslovakia. These two countries dominate production of handkerchief fabric. Very little of such fabric, if any, is manufactured in the United States. The fabric is imported in the greige or processed by bleaching only. In the manufacture of handkerchiefs, no further work is done on the fabric. Most handkerchief-making machinery is designed to cut the fabric on three sides, leaving the selvage sides uncut. Handkerchiefs are usually sewn on three sides only, again, leaving the selvage side unsewn. If the Annex 311 Rules are adopted at the international level, these handkerchiefs, which most countries now deem to be a product of the United States, would become products of Czechoslovakia or the PRC. If that occurs, importation into the European Union will require an export license or visa from the PRC. There can be little doubt that the PRC will not issue an export license or visa for these handkerchiefs, since, they were manufactured in the United States. Clearly, firms and workers in the United States will suffer if this rule is adopted at the international level.

A second example, involving bandannas and scarves, is even more compelling. These products, when made in the United States from imported greige goods, undergo a variety of processes including bleaching, dyeing, printing, cutting and sewing. As with the handkerchiefs, it is likely that the selvage side of the finished fabric will be left uncut and unsewn. Accordingly, these bandannas will not be deemed to be products of the United States but products of the country, usually the PRC, where the fabric was formed. Again, as with handkerchiefs, domestic producers will find it difficult to market their products abroad if they have to declare the PRC as the country of origin. In addition to marketing difficulties, there are likely to be quota restrictions which would not apply if the products were considered to be of United States origin. The adverse impact on domestic manufacturing and employment is obvious.

The solution is simple. The Annex 311 Rules should be amended so that a change in classification from fabric to a complete article such as a handkerchief or bandanna represents a change in origin. This is the only rule which will protect United States export interests.

Similar comments apply to various products, particularly home furnishings and the like, classified in Chapter 63 of the Harmonized Tariff Schedule of the United States. Under the Annex 311 Rules, as revised, only a change in classification which results from cutting finished fabric on all sides and hemming all cut edges plus at least one other subsequent process, no consideration being given to minor embellishments, will result in a change in origin. As with accessories, restrictive rules of this nature will have an adverse impact on the ability of domestic firms to sell their products in export markets. Again, if the fabric is made in the PRC, these rules would require that the products be labeled as originating in the PRC, a fact which will create marketing and admissibility problems.

The Annex 311 Rules should be amended to reflect the commercial reality that some of these types of products are cut on three sides, not four, because the selvage edge is neither cut nor sewn. Cutting on three sides instead of four should not require that origin be fixed as the place where the fabric was formed. Clearly, the processing involved does involve a substantial transformation and should be recognized as such.

There is another potential problem with the Annex 311 Rules as revised. As noted, cutting and sewing plus at least one other subsequent process with no consideration being given to "minor embellishments" is required if processing is to constitute a change in origin. The term "minor embellishments" is defined as "relatively insignificant methods used to enhance the visual appeal of a good, e.g., piping, capping, small amounts of embroidery". This is a relatively subjective definition (What is a small amount of embroidery?). Again, in developing a rule which will be applied at the international level, it is very important that the rule be based on objective criteria and that subjective considerations be avoided. If the requirement for processing of a product classified in Chapter 63 is to exclude so-called "minor embellishments", the term must be revised in order to make it more objective.

There are other problems with the Annex 311 Rules which limit its utility as the basis for a United States position in WTO negotiations on rules of origin. Objectivity is an essential requirement of international rules of origin. Some of the Annex 311 Rules are far too subjective to meet this requirement. One example will suffice to illustrate this deficiency.

The Annex 311 Rules provide that assembly confers origin in some garments, among them tailored shirts with a stated number of parts. The term "tailored" refers to:

> noncasual garments of the type normally worn for business or social purposes where some degree of formality is required, and garments of virtually identical construction. These garments have been permanently shaped and usually have trim, fitted lines obtained by careful cutting, seaming and pressing.

The definition includes subjective concepts such as "non-casual" and "some degree of formality", as well as terms whose meaning is vague and obscure. These terms likely will lead to controversy and confusion, and, if adopted at the international level, these terms, because they are open to subjective interpretation, could lead to abuse and permit discrimination against United States exports.

Assume a garment which is assembled in the United States using cut parts imported from a country whose exports to the European Union are subject to quantitative restrictions. Officials in the European Union could deny entry to these "tailored" garments because they are "casual" or because they are not of the sort the examining official would wear on an occasion where "some degree of formality" is required. Origin might depend on the

country of importation (some countries have more formal cultures) or the age of the examining official (younger officials tend to dress less formally). These possibilities for abuse should be avoided.

The Annex 311 Rules also require that a minimum number of major parts be involved if assembly is to confer origin. This is an objective standard and one which should be adopted as sufficient in and of itself.

The reference to "tailored" garments is not necessary. Including this concept could lead to abuses, and certainly is not in keeping with the goal of a harmonized set of rules which are "predictable". The term "tailored" is far too ambiguous and far too vague to ensure predictable results.

The Annex 311 Rules are not an ideal basis for an international standard. However, if amended to eliminate subjective elements such as "tailored" and to rationalize the treatment of apparel accessories and home furnishings, they could serve as a useful basis for a balanced United States position.

* * *

On the other hand, if the Section 334 Rules were to be adopted at the international level, United States exports will suffer markedly. The situation is particularly egregious for fabric converters and manufacturers of textile products other than apparel.

Section 334. Under the Section 334 Rules, the country of origin of a fabric is the place where the fabric is formed, i.e. where the greige goods are woven or knit. Subsequent processing, regardless of how complex, will not change origin. This is likely to have a severely adverse affect on United States fabric converters to the extent that they use imported greige goods. The processing performed in the United States will not change origin. It will not be possible for the goods to be marked as "Made In USA". The goods will be subject to the same quota restrictions as are applied to products of the country where the greige goods were formed.

In effect, Section 334 establishes a "yarn forward rule" for fabric. While such a rule might be sensible as a preference rule of origin, clearly it is not justifiable as the basis for international rule of origin for non-preference matters. The Section 334 Rules should not be proposed as a basis for the United States position on the origin of fabric.

The Section 334 Rules applicable to accessories and furnishings provide that the country of origin is the place where the fabric is formed. As noted above, the Annex 311 Rules create significant problems for domestic manufacturers of such products. The Section 334 Rules will make it even more difficult for them to compete in international markets. Again, the Section 334 Rules should not be used as the basis of the United States position in negotiating international rules on the origin of accessories and furnishings.

The impact is best illustrated by reference to a few of the comments submitted to the Customs Service in response to the proposed Section 334 Rules. Pillowtex Corporation of Dallas, Texas, a domestic manufacturer of bedding products, stated that its products, because it must use imported fabric, there being an insufficient supply of domestic product, would be considered a foreign for marking purposes. The Company Store, a Wisconsin-based domestic manufacturer of down comforters is faced with a situation in which its U.S.-made product will have to be labeled "Made in China" because it can source down-proof fabric only from China. Cranston Print Works Company, an employee-owned concern based in Cranston, Rhode Island, urged that the rules on fabric be amended to take into account the considerable value it adds by printing and finishing fabrics. Finally, the Schiffli Lace and Embroidery Manufacturers Association, Inc. of North Bergen, New Jersey, commenting on the Section 334 Rules applicable to lace and embroidery (the country of origin is the place where the base fabric is formed),

characterizes the rules as "ludicrous". These domestic manufacturers are not members of USA-ITA. They do, however, share our view that the Section 334 Rules will disadvantage many domestic producers, particularly in their ability to compete in foreign markets.

CONCLUSION

USA-ITA strongly supports United States participation in the WTO negotiations on rules of origin. We understand that the purpose of these negotiations is to develop harmonized nonpreferential rules of origin which are designed to make origin determinations impartial, predictable, transparent, consistent and neutral. This is a laudable goal. Unfortunately, neither the Annex 311 Rules as currently proposed nor the Section 334 Rules are suitable for this purpose, at least in the textile and apparel sector. Although USA-ITA generally supports rules based on specified changes in tariff classification, the Annex 311 Rules, as currently envisioned, contain too many non-objective elements and would severely disadvantage many United States exporters. The politically-driven Section 334 Rules would have an even more devastating effect on United States exports of completed fabric, apparel accessories and textile home furnishings.

The United States position in the WTO negotiations should be based on the Annex 311 Rules, revised to eliminate subjective elements such as "tailored" and to rationalize the treatment of apparel accessories and textile home furnishings. The Section 334 Rules should not be considered for this purpose. They would be an unmitigated disaster for many United States firms and workers.

Regrettably, in the textile and apparel sector in the United States, rules of origin have become tools for protectionism, and that fact may come back to haunt us. As is clear from our statement, the Section 334 Rules in particular are incredibly short-sighted, and if applied on an international basis would be highly detrimental to our own domestic industry, devastating its ability to effectively export. This Committee must question why the United States should implement, especially for only a short period of time, a set of rules that could not logically provide a basis for the U.S. negotiating position in the WTO.

We commend the Committee for holding this hearing now, before either the Annex 311 Rules or the Section 334 Rules are finalized. The U.S. should not be racing to implement new rules, for the less than noble purposes of having a firmer negotiating position or causing short-term disruptions in the import market. We hope that this Committee will take the initiative to ensure that more foresight is given to the development of new rules and the U.S. negotiating position in the WTO. Finally, we urge this Committee to act to correct the inequities of Section 334 in light of the serious problems created by the Administration's delay in promulgating the rules, the date of import implementation requirement, and the devastating consequences on domestic producers.

Chairman CRANE. Thank you, Mr. Pellegrini.
Mr. Morgan.

STATEMENT OF GEORGE MORGAN, VICE PRESIDENT, MAST INDUSTRIES, INC., ANDOVER, MASS.

Mr. MORGAN. Mr. Chairman and members of the subcommittee, my name is George Morgan. I am vice president of Mast Industries, Inc., a global contract manufacturer and distributor of women's, men's, and children's apparel. Mast Industries is a subsidiary of The Limited, Inc., and I am testifying today on behalf of both companies.

The Limited is the largest specialty apparel retailer in the United States, operating over 4,900 stores nationwide through Limited Stores, Lerner New York, Lane Bryant, Express, Victoria's Secret, Structure, Limited Too, Abercrombie & Fitch, Henri Hendel, Cacique, Bath & Body Works, and Penhaligon's. The Limited generated over $7 billion in sales in 1994 and employs over 100,000 associates.

I want to thank you, Mr. Chairman, for initiating this examination of rules of origin. This hearing is particularly timely, as the U.S. Customs Service is in the process of finalizing an extremely significant and pervasive change in the rules of origin for imported apparel products.

I welcome the opportunity to tell the subcommittee how our company, the consumers we serve, the U.S. Government, and countless others will be affected by this change, and to request your consideration of a reversal of what I believe to be a costly, burdensome, and poorly considered change in the rules that govern trade in the products we sell. This new rule was adopted without an assessment of its impact on U.S. businesses, consumers, and others. Our company has previously provided comments to the Customs Service on this new rule, and I hope that my testimony will help shed more light on the impacts of this change.

I would like to describe in further detail the "real world" disruption caused by this change in rules or origin.

We are faced with an absurdly short period of time in which to make a huge and costly adjustment to our overseas sourcing plans. The Uruguay Round Act stipulates that the new rule will take effect on July 1 of next year. That is now less than 1 year away, and the Customs Service has yet to promulgate a final version of the new rule which we can use as the basis for planning. We were assured during debate of the Uruguay Round Act that we would have at least 18 months in which to adjust to the rule change. We are now down to less than 12 months, and the clock is running.

Once the final rule is published, we must begin a costly and time-consuming process of evaluating our current sourcing arrangements, and determining if and how to shift our overseas production and sourcing in order to meet the requirements of the new rules and their affect on import quotas. This must be accomplished while maintaining an uninterrupted flow of clothing and related items to our customers.

For example, clothing that we are currently cutting in the Maldives for assembly in Sri Lanka will, after the rule change, be considered products of Sri Lanka and subject to that country's

quotas. But we have no way of assuring that Sri Lanka's quota levels for the products in question will be adjusted to cover this shift in Customs treatment.

The Office of the U.S. Trade Representative has said it will renegotiate quota levels to reflect the change in rules. However, USTR's textile staff is small. With some 40 bilateral textile agreements affected by this shift and potentially subject to renegotiation, can we plan on a timely and reasonable adjustment of quota levels? With the short period of time available, this is very questionable. How are we to sensibly plan our business under these circumstances?

Furthermore, and especially troublesome to us from a planning standpoint, the change in rules of origin is being implemented in full knowledge that the World Trade Organization is beginning a project to harmonize global rules of origin. This only further complicates our planning efforts, which will invariably lead to increased costs to us and to our customers.

We fail to understand how or why our government chose to implement a major, disruptive rule change now, thus preempting a coordinated international effort agreed to by U.S. negotiators during the Uruguay round, our business faces the prospect of two disruptive shifts in origin rules in the space of less than 5 years: First in 1996, when the new U.S. rule is implemented, and again in 1998 when WTO members implement the harmonized rules arising from the current global effort.

The adjustment to new rules of origin will cost our company several hundred million dollars, including lost sales from apparel no longer affordable to consumers and writeoffs of investments in people and other assets which support our current sourcing base. The rule change and its effect on quota availability will force us to shift our sourcing to more expensive suppliers and absorb additional costs ourselves, as well as passing some portion of these costs along to our customers. Clearly, this will only aggravate the already absurd situation in which protectionist trade policies force American families to pay as much as $700 per year more on clothing than would be the case in the absence of current restrictions.

The rush to adjust to new rules will also hurt a great many people in the apparel production process, and not all of them in foreign clothing factories. American workers involved in importing, shipping, and distributing apparel are also likely to be affected, at least temporarily, by this disruption in trade. It will also damage prospects for expanding U.S. export prospects abroad. By limiting the amount of hard currency our current apparel suppliers earn through clothing exports, U.S. policy effectively imposes an offsetting limitation on the ability of U.S. companies to sell otherwise competitive American products in those markets. Again, American workers lose.

Moreover, the rule change will force us to abandon relationships built up over many years with reliable, quality-conscious, and cost-effective suppliers of clothing. In many cases, we will have to start from square one to establish new relationships in new countries. To find new factories requires an investment of both time and money, it is not a simple process, and it cannot be accomplished quickly.

Finally, I think that U.S. Government revenues will decline as a result of the rules change. Annual U.S. apparel imports currently approximate $33 billion. If 10 percent of apparel imports involve multicountry processing—and I think that this is a conservative estimate—and those goods will not be able to be produced and shipped from locations whose quotas are negatively impacted by the new rules of origin, U.S. tariff revenue could be reduced by over $500 million based on a 15-percent tariff rate.

To the best of my knowledge, no analysis was ever completed of this potential impact of a change in rules of origin. Given this potentially adverse impact, it is important to defer any change in the rules of origin until both appropriate analysis is completed and the World Trade Organization completes its work on rules of origin harmonization.

We are also convinced that the rule change is contrary to the spirit of the Uruguay round, both in terms of textile and apparel trade liberalization and liberalization of rules of origin. The GATT 1994 agreement on rules of origin requires GATT members to ensure that changes in rules of origin undertaken prior to the completion of the WTO harmonization work program do not "create restrictive, distorting, or disruptive effects on international trade." That is a quote from the legislation. As I have made clear in this statement, there is no question that the proposed rule is all of these things—restrictive, distorting, and disruptive.

I find it extremely troubling that the legislation which led to this rule change was adopted—and the rule has been developed by Customs—without any serious analysis of its impact on the U.S. economy, on the U.S. work force, or on American businesses. The amendment mandating the rule change may have been adopted in violation of "fast track" rules for considering trade agreements. Those rules state that any amendments must be "necessary and appropriate" to implementation of the trade agreement, which is the subject of the legislation. I do not see how the rule of origin change adopted as part of the Uruguay round bill meets that agreement—particularly since, as I noted, it appears to run counter to the spirit of the round.

Finally, Mr. Chairman, you are aware of our view that U.S. textile and apparel trade policy remains characterized by a brand of protectionism which is out of step with broader U.S. trade policy and is far more harmful to consumers than it is helpful to domestic textile and apparel industries. The use of rules of origin to ensure the continued restriction of trade has become an important part of this practice of protectionism. The inclusion of a change in rules of origin as part of the Uruguay Round Agreements Act was inappropriate to that legislation, harmful to trade, and expensive for consumers.

For all of these reasons, I urge the subcommittee to review the rule of origin change mandated by the Uruguay Round Act, with a view either to repealing the relevant provision of the act or to assuring through legislation that any change in U.S. rules of origin for textile and apparel products is coordinated, in both timing and substance, with the WTO harmonization program. In other words, do not make any changes in rules of origin until the WTO process

is completed. Such an action would be good for business and, most importantly, good for the consumers of this country.

Again, thank you, Mr. Chairman, for the opportunity to testify on this important issue.

Chairman CRANE. Thank you, Mr. Morgan.

Mr. Hansen.

STATEMENT OF CHARLES M. HANSEN, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PILLOWTEX CORP., DALLAS, TEX.

Mr. HANSEN. Good afternoon. My name is Chuck Hansen, and I am chairman and chief executive officer of a company called the Pillowtex Corp., headquartered in Dallas, Tex. I have been in this company for 30 years. We started out as a pillow company and we are now the fourth largest manufacturer in the world of home textiles.

I come to this subcommittee hearing this afternoon to talk about why the rules of origin as they are being changed are going to affect my company, and I have checked one particular item which is extremely important and represents over 10 percent of our sales. Our sales this year are estimated by analysts at about $500 million, and that being the down comforter. Many of you probably have one.

Let me tell you what goes into a down comforter. Pillowtex invested $8 million in the largest down processing facility in the United States, and we think probably the world. Up to this point, with the affirmation of the Treasury Department, particularly in the Customs area, we have been told that if we buy a comforter shell from offshore and fill it with down and label it and package it and send it to a retailer, that we have significantly transformed the original product which was a sewn comforter shell into something called a down comforter. Or it could be filled with whatever, but in essence we have changed the product itself from fabric into a usable product.

It is interesting to note that down-proof fabric cannot be purchased in this country. There is no domestic mill of all the mills available in the textile industry in the United States that can supply this fabric. There really are only three countries in the world that we are able to buy the fabric from. One is Germany, one is India, and the other is China.

So that fairly well nails down that if this rule goes through as it is proposed, if everything stays the same right now, we will never ever be able to make another American-made down comforter. We can process the down here, we can fill it here, we can sew it here. But if that fabric in whatever state comes from outside the United States, we are going to have to say that product was made out of the United States.

I think there is some absolute common sense that has to prevail in terms of what we call our products all the way through. We are very proud of what we do. We employ 4,000 people and we have competed on an international basis consistently throughout our years. We have experienced the import issues in terms of our products and, for that matter, we enjoy a good contest. It is not easy surviving in the worlds of textiles, but in my 30 years here this company has gone from $1.5 million to $500 million, so we must

know how to compete. We have also added a lot of jobs in America—Illinois, for one, California, Pennsylvania, Mississippi, the Carolinas, and Texas. We are very proud of that.

We believe that if this rule goes through, we then will have to tell the people who are working in our factories that you are going to make a product that we are primarily going to sell in America, but you cannot take credit for it. As a matter of fact, as I was sitting here today, I thought to myself, well, perhaps I ought to tell the unions that represent the various hard workers at Pillowtex that when we put the label on there and it says the product was sewn and manufactured on that label, that it really came from India.

It did not come from India. It was manufactured by people who live and work in the factories in Hanover, Pa., or Chicago or Los Angeles, Calif. So my appeal is not necessarily along the same lines as we drafted for presentation in my comments, but I appeal to the real common sense. Mr. Chairman, I ask you and your subcommittee to understand that this issue about fabric forward, especially as it applies to down comforters, is extremely unfair. If there were alternatives available, that would be one thing, but in our case there are no alternatives available.

I would also point out that it is not that we have not sought other alternatives. That has not been the case. But the case is what we have to deal with all the way through. So if we cannot call it a product made in America—and I think all of us in this room want to make products made in America—then what are we all about? What are we about?

Mr. Chairman, I will cut mine short. I have been hit with the yellow light. Thank you very much for letting me be here today.

[The prepared statement follows:]

STATEMENT OF CHARLES M. HANSEN, JR.
CHAIRMAN AND CEO OF PILLOWTEX CORPORATION
BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE OF TRADE
ON RULES OF ORIGIN

July 11, 1995

Good afternoon, my name is Chuck Hansen, and I am Chairman and CEO of Pillowtex Corporation, which is headquartered in Dallas, Texas. Pillowtex is the fourth largest U.S. manufacturer of home textiles, which includes pillows, comforters, blankets and other home furnishings. We employ nearly 4,000 workers at ten different facilities across the United States. We have built the largest feather and down processing facility in North America outside of Dallas. Today, I would like to explain to the this Subcommittee the problems Pillowtex has encountered with rules of origin as they apply to a single product -- down comforters, of which Pillowtex is the largest U.S. manufacturer. This problem now applies to both our domestic production and import programs. However, in order to do so, I believe it would be helpful if I first briefly explained how down comforters are manufactured.

Down comforters are produced from a specialty fabric known as "down proof" fabric. The name aptly describes the product. The fabric is woven on a wide loom, has a very high thread count, and goes through an additional finishing process that compresses the fabric in order to prevent down from escaping. Despite our efforts, Pillowtex has been unsuccessful in finding any U.S. source of this fabric. Simply stated, the amount of such fabric required by Pillowtex and other U.S. comforter manufacturers has not warranted U.S. mills to produce this fabric. Therefore, Pillowtex, and all other domestic manufacturers of down comforters, must use imported fabric or imported comforter shells in their U.S. manufacturing operations. Currently, only three countries -- China, India and Germany -- produce commercial quantities of down proof fabric.

The other component used in the production of down comforters is, of course, down. Before down can be used to fill a comforter, a pillow or any other product, the raw feathers from which down is refined must be washed, cleaned, sorted, and processed into down. As I indicated at the outset, Pillowtex has built the largest down processing facility in North America in Dallas, Texas. This facility alone cost Pillowtex over $8,000,000 to build. I am here today to seek your support to maintain this facility, as well as our other facilities, as viable U.S. manufacturing plants.

For a number of years, the Department of Treasury has issued rulings holding that the origin of a down comforter is conferred by the process of filling the fabric comforter shell with down. In my opinion, these decisions are consistent with the traditional substantial transformation origin test, because a comforter shell alone cannot provide a person with warmth and feathers alone are obviously not a suitable bedding product. It is the <u>combination</u> of these two articles that results in a new and different product of commerce known as a down comforter.

This origin position was affirmed last summer by a Treasury ruling holding that when a comforter shell is imported into the United States and filled with down, the finished comforter is a product of the United States. Last winter, however, Treasury reversed its position and held that the origin of comforters is the country where the shell is produced. In April of this year, Treasury reversed itself yet again with with no explanation of its legal reasoning.

In addition to conflicting administrative decisions, Pillowtex is now faced with conflicting country of origin regulations. Under the NAFTA country of origin rules, origin is conferred by the process of filling the fabric comforter shell with down. However, under Treasury's proposed

Uruguay Round Act country of origin rules, origin is conferred by the country where the fabric used in the construction of the comforter shell is woven. If this last rule goes into effect as proposed, there will be no more "U.S. Made" down comforters as far as the Treasury Department is concerned. Every comforter manufactured and sold in the United States will be considered to be a product of China, Germany or India depending on where the down-proof comforter fabric was woven.

A further complication results from the fact that none of the foreign markets into which Pillowtex sells its comforters have country of origin rules similar to those proposed by the U.S. under the Uruguay Round Act. For example, under Canadian and Mexican law, a down comforter produced at one of Pillowtex' U.S. plants from a Chinese origin comforter shell is considered to be a product of the United States. Yet, under the proposed Uruguay Round Act rules, this same comforter would have to be labeled a product of China when sold domestically. One obvious dilemma we face is that country of origin labels are sewn into comforters during production. However, at the time of production we don't know whether a particular comforter will be sold domestically or in an export market. Thus, we have no way of knowing how to label the comforter. Clearly, this proposed rule does not promote certainty for U.S. manufacturers like Pillowtex.

The inconsistent series of administrative decisions and origin rules Pillowtex faces with respect to this one product has made it virtually impossible for us to plan for the future. We don't know whether the fabric, the shell, or the filling operation will determine the origin of finished down comforters. In addition, imported down comforters are faced with quota restrictions. This additional requirement exacerbates our planning problem, because it is essential that a country with a sufficient quota allotment is considered to be the country of origin of the finished down comforter.

I would like to point out that if the proposed rule of origin under the Uruguay Round Implementation Act goes into effect, Pillowtex will have little incentive to use its domestic resources. If the finished comforter will be considered to be a product of the country where the fabric is woven, it will be much more economical to purchase finished comforters from manufacturing companies in India and China where labor costs are low, rather than to retain a portion of production here in the United States. Due to the unavailability of domestically woven down proof fabric, this proposed rule is not in the interests of any domestic industry and will be harmful to our employees.

It is my understanding that, in addition to the two sets of conflicting country of origin rules proposed by Treasury, the World Trade Organization will shortly begin to draft universal country of origin rules. Pillowtex is hopeful that these rules will allow companies the flexibility required to develop production and marketing strategies that can adapt to changes in the market place. Certainly, the proposed origin rule under the Uruguay Round for comforters does not allow such flexibility. Pillowtex is also hopeful that Congress, and in particular the Members of this Committee, carefully consider the negative impact of the proposed Uruguay origin rules and take corrective action to preserve the existence of U.S. down comforter manufacturers and the jobs they create in North America.

Thank you very much.

ATTACHMENT I

CONFLICTING RULES OF ORIGIN

Canada's NAFTA Rule of Origin for Down Comforters:

"9404.90	A change to subheading No. 9404.90 from any other heading."

Mexico's NAFTA Rule of Origin for Down Comforters:

"9404.90	A change to subheading 9404.90 from any other heading."

Proposed U.S. NAFTA Rule of Origin for Down Comforters:

"9404.30 - 9404.90	A change to down and/or feather filled goods of subheading 9404.30 through 9404.90 from any other heading; or for all other goods of subheading 9404.30 through 9404.90, a change from any other heading except from heading 5007, 5111, 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5804, 5806, 5809, through 5810, 5901, 5903 through 5904, 5906 through 5907, 6001 through 6002, and 6307.90."

Proposed U.S. Uruguay Round Rule of Origin for Down Comforters:

"9404.90.80 - 9404.90.95	A change to subheading 9404.90.80 through 9404.90.95 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5806, 5809, through 5811, 5903, 5906 through 5907, 6001 through 6002, and 6307.90, and provided that the change is the result of a fabric-making process."

ATTACHMENT II

CONFLICTING RULE OF ORIGIN RULINGS BY TREASURY DEPARTMENT

NY 893265 December 23, 1993 CLA-2-94:S:N:N6:349 893265 CATEG

NY 893265

December 23, 1993

CLA-2-94:S:N:N6:349 893265

CATEGORY: Classification

TARIFF NO.: 9404.90.8010

RE: The tariff classification of a goose down comforter from Canada.

Dear Mr. Wozny:

In your letter dated December 9, 1993, you requested a tariff classification ruling.

You have submitted photographs, package inserts and a sample swatch of fabric. The shell of the goose down comforter will be made in China from a 100 percent cotton woven fabric as represented by the sample swatch. The shell is shipped to Canada where it is filled with white goose down that is obtained from Canadian or United States suppliers. The shell is sewn closed, quilted and packed. The down comforters in the photographs do not appear to contain any embroidery, lace, braid, edging, trimming, piping exceeding 6.35 millimeters or applique work. Inclusion of any of these features on the imported comforters will result in a change in classification.

The applicable subheading for the down comforter will be 9404.90.8010, Harmonized Tariff Schedule of the United States (HTS), which provides for mattress supports; articles of bedding and similar furnishing (for example, mattresses, quilts, eiderdowns, cushions, pouffes and pillows) fitted with springs or stuffed or internally fitted with any material or of cellular rubber or plastics, whether or not covered: other: other: of cotton, not containing any embroidery, lace, braid, edging, trimming, piping exceeding 6.35 mm or applique work... quilts, eiderdowns, comforters and similar articles. The rate of duty will be 5 percent ad valorem.

Goods classifiable under subheading 9404.90.8010, HTS, which have originated in the territory of Canada, and are imported on or prior to December 31, 1993, will be entitled to a 2.5 percent ad valorem rate of duty under the United States-Canada Free Trade Agreement (FTA) upon compliance with all applicable regulations. Effective January 1, 1994, with the implementation of the North American Free Trade Agreement (NAFTA), preferential tariff treatment for goods under the FTA will be discontinued.

This ruling is being issued under the provisions of Section 177 of the Customs Regulations (19 C.F.R. 177).

comforters
d:\rulings\94ny08\893265.ext

DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE
NEW YORK, N.Y.

NY 899334
JUL 22 1994

REFER TO

MAR-2-94:S:N:N6:349 899334

CATEGORY: MARKING

Mr. Sidney H. Kuflik
Lamb & Lerch
233 Broadway
New York, NY 10279

RE: COUNTRY OF ORIGIN MARKING OF IMPORTED COMFORTER SHELLS.

Dear Mr. Kuflik:

This is in response to your letter dated May 24, 1994, received by this office on June 27, 1994, requesting a ruling on whether comforter shells imported by your client, The Company Manufacturing Inc., are required to be individually marked with the country of origin if it is later to be processed in the U.S. by a U.S. manufacturer. Samples of the shell and finished down comforter were submitted with your letter for review. The samples will be returned as requested.

The Company Manufacturing Inc. imports 100 percent cotton comforter shells from China and Hong Kong to be further manufactured into down comforters. You state that once imported the following processing steps will be performed in the United States.

1. The shells arrive at the manufacturing facility and are unloaded and sorted by size, color, thread count and style.

2. Shells are inspected for proper size, weaving, dyeing and finishing defects, accuracy of color, sewing quality, evidence of dirt, stains, holes, etc.

3. After inspection the shells are re-folded for ease of filling and bagged for storage.

4. Duck or goose down, which is fully processed in the U. S., is sorted and tagged for storage. Random samples are taken to check the fill power, makeup and cleanliness. Down which passes these tests is approved for use in comforter production.

5. Shells are brought to a specially constructed filling room which is equipped with its own HVAC system to ensure proper temperature and humidity levels. This stable and controlled environment is required for the computer driven "Down Delivery System" to function within prescribed tolerances.

6. The opening of the comforter shell is placed on the filling tube. A pneumatic device is engaged to hold the shell in place while filling. The machine operator enters the appropriate fill weight into the "Down Delivery System". Down is then released from the holding tank and is drawn into the weight cell. This shot of down is weighed, checked and forced under pressure into the empty shell.

7. The filled shell is released from the pneumatic device and a temporary closing device is placed over the opening to keep the down in place.

8. The filled shell moves to a double needle sewing machine where the labels are inserted into the opening. A skilled seamstress sews the opening closed, matching the quality and appearance of the other double needle stitches. A random audit is then used to insure that fill amounts are within a plus or minus two percent tolerance.

9. The filled comforter shell moves to the quilting area. Each filled shell is laid flat on a specially designed table where it is placed in a quilting frame built specifically for the size of the individual comforter. Indirect lighting built into the table allows the machine operator to see through the fabric while evenly distributing the down inside the fabric shell.

10. The comforter is loaded into a "Hauser Automated Quilting Machine". The appropriate stitch design program is loaded into the machine's computer disk drive. The automatic quilting machine moves the framed comforter based on programmed coordinates under the sewing head. The program signals the machine to stitch each length, curve or pattern required. The machine follows the program until the quilting cycle is completed.

11. The comforter is removed from the quilting machine and inspected on the "light table" where loose threads are clipped, spots removed and general sewing and fabric quality is evaluated. Comforters not meeting quality standards are re-worked or designated as factory seconds.

12. The comforter is then folded and placed in the appropriate packaging along with product inserts and a desiccant to control moisture.

13. Completed lots are sent to the finished goods inventory where they are inspected and compared to established quality standards.

The marking statute, section 304, Tariff Act of 1930, as amended (19 U.S.C. 1304), provides that, unless excepted, every article of foreign origin (or its container) imported into the U.S. shall be marked in a conspicuous place as legibly, indelibly and permanently as the nature of the article (or its container) will permit, in such a manner as to indicate to the ultimate purchaser in the U.S. the English name of the country of origin of the article.

Part 134, Customs Regulations (19 CFR Part 134), implements the country of origin marking requirements and exceptions of 19 U.S.C. 1304. Section 134.41(b), Customs Regulations (19 CFR 134.41(b)), mandates that the ultimate purchaser in the U.S. must be able to find the marking easily and read it without strain. Section 134.1(d), defines the ultimate purchaser as generally the last person in the U.S. who will receive the article in the form in which it was imported. 19 CFR 134.1(d)(1) states that if an imported article will be used in manufacture, the manufacturer may be the ultimate purchaser if he subjects the imported article to a process which results in a substantial transformation of the article. The case of U.S. v. Gibson-Thomsen Co., Inc., 27 C.C.P.A. 267 (C.A.D. 98) (1940), provides that an article used in manufacture which results in an article having a name, character or use differing from that of the constituent article will be considered substantially transformed and that the manufacturer or processor will be considered the ultimate purchaser of the constituent materials. In such circumstances, the imported article is excepted from marking and only the outermost container is required to be marked. See, 19 CFR 134.35.

The Company Manufacturing Inc. is the last person in the U. S. who will receive the shell in its imported condition. Although the manufacture of the shell is a substantial manufacturing operation, the conversion of the shell into a down comforter is also a substantial processing operation and results in an article having a name character and use differing from that of the imported article. The value added by the use of a down fill, the complexity and skill necessary to make this conversion is substantial. The sew through quilting in a down comforter is designed to hold the down in place while allowing sufficient room to "loft". Stitch patterns selected play a significant role in the loft possible in each comforter and are critical in the degree of warmth that the comforter will provide. In response to a domestic party petition, the Customs Service decided in T.D. 94-25 that "...down filling imparts the essential character to a down comforter. The characteristics and quality of a down comforter are imparted by the down filling. We do not agree with those who stated that the outer shell gives a down comforter its distinctiveness, since many down comforters have a fairly plain and undecorated outer shell".

In this case, the imported shells are substantially transformed into down comforters as a result of the U.S. processing, and therefore the U.S. manufacturer is the ultimate purchaser of the imported shells and under 19 CFR 134.35 only the containers which reach the ultimate purchaser are required to be marked with the country of origin "China" or "Hong Kong".

This ruling is being issued under the provisions of Part 177 of the Customs Regulations (19 CFR Part 177).

A copy of this ruling letter should be attached to the entry documents filed at the time this merchandise is entered. If the documents have been filed without a copy, this ruling should be brought to the attention of the Customs officer handling the transaction.

Sincerely,

Jean F. Maguire
Area Director
New York Seaport

HQ 956320

December 12, 1994

CLA-2 CO:R:C:T 956320 CAB

RE: Country of origin of down comforters; Section 12.130, Customs Regulations

Dear Ms.

This is in response to your inquiry of April 7, 1994, requesting a determination, on behalf of ., as to who is the ultimate purchaser of comforter shells imported into the United States and used in the production of down comforters. Customs believes that the issue of who is the ultimate purchaser is contingent upon where the subject merchandise undergoes its last substantial transformation and therefore will make that determination based on Section 12.130, Customs Regulations (19 CFR 12.130). There was no sample submitted for examination.

FACTS:

The importer contemplates importing comforter shells constructed of either cotton or man-made fiber fabric from Hong Kong and/or China. These comforter shells will be sized based on client specifications of twin, full, queen, or king sizes. These comforter shells will be cut and sewn in Hong Kong and/or China and then exported to the United States where they will be filled with either down, feathers, or man-made wadding. The comforter shell edges are sewn together except for one or more fill openings that are left open so that the fill can be placed inside the shell. Shell construction can range from a simple "no sew" bag, to shells that have "blocks" or separate compartments in order to prevent migration of filling material. These compartments or blocks are created by sewing vertical strips called "baffles" through the top and bottom layers of the comforter shell.

The importer has imported empty comforter shells in an unmarked condition into the Port of Chicago, Illinois. These particular shells are the subject of three notices of marking which where issued by the District Director in Chicago.

ISSUE:

Where does the subject merchandise undergo it last substantial transformation?

LAW AND ANALYSIS:

Section 304 of the Tariff Act of 1930, as amended (19 U.S.C. 1304), provides that unless excepted, every article of foreign origin imported into the U.S. shall be marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the article (or its container) will permit, in such a manner as to indicate to the ultimate purchaser in the U.S. the English name of the country of origin of the article.

The "ultimate purchaser" is defined generally as the last person in the U.S. who will receive the article in the form in which it was imported. See, 19 CFR 134.1(d). If an imported article will be used in domestic manufacture, the manufacturer may be the "ultimate purchaser" if he or she subjects the imported article to a process which results in a substantial transformation of the article. However, if the manufacturing process is a minor one which leaves the identity of the imported article intact, the consumer or user of the article, who obtains the article after the processing, will be regarded as the "ultimate purchaser." 19 CFR 134.1(d)(1) and (2).

The issue of who is the ultimate purchaser of the imported comforter shell hinges on whether the shells are substantially transformed in the U.S. as a result of the processing performed there.

Country of origin determinations for textile products are subject to Section 12.130, Customs Regulations (19 CFR 12.130). Section 12.130 provides that a textile product that is processed in more than one country or territory shall be a product of that country or territory where it last underwent a substantial transformation. A textile product will be considered to have undergone a substantial transformation if it has been transformed by means of substantial manufacturing or processing operations into a new and different article of commerce.

Section 12.130(d), Customs Regulations, sets forth criteria for determining whether a substantial transformation of a textile product has taken place. This regulation states these criteria are not exhaustive; one or any combination of criteria may be determinative, and additional factors may be considered.

Section 12.130(d)(1), Customs Regulations, states that a new and different article of commerce will usually result from a manufacturing or processing operation if there is a change in:

(i) Commercial designation or identity, (ii) Fundamental character or (iii) Commercial use.

Section 12.130(d)(2), Customs Regulations, states that for determining whether
merchandise has been subjected to substantial manufacturing or processing operations, the following will be considered:

(i) The physical change in the material or article

(ii) The time involved in the manufacturing or processing operation

(iii) The complexity of the manufacturing or processing operation

(iv) The level or degree of skill and/or technology

(v) The value added to the article or material

Section 12.130(e)(1)(iv), Customs Regulations, states that a textile article will usually be a product of a particular country if the cutting of the fabric into parts and the assembly of those parts into the completed article has occurred in that country. However, 12.130(e)(2)(ii), Customs Regulations, states that a material will usually not be considered to be a product of a particular
foreign country by virtue of merely having undergone cutting to length or width and hemming or overlocking fabrics which are readily identifiable as being intended for a particular commercial use.

The processing of the subject comforters is as follows: Fabric is cut and sewn into comforter shells in Hong Kong and/or China. One or more fill openings is left unattached so that either down, feathers, or man-made wadding can be placed into the comforter shell. The comforter shells are exported to the United States where they are filled with any one of the specified fillers. You assert that the filler and comforter shell undergo substantial manufacturing operations in the United States which results in a new and different article of commerce, a down comforter. You specifically state that the time involved in the operations performed in the United States exceeds the time involved in cutting and sewing the comforter shell. Of significance is the fact the complexity and technological skill required to clean and blow the feathers into the shell far exceeds the complexity and technological skill necessary to make a shell, which is a simple cutting and sewing operation. Recently, Customs confronted a similar issue in Headquarters Ruling Letter (HRL) 955975, dated June 21, 1995, when it determined that a quilt shell cut and sewn in China and filled with a polyester wadding in Indonesia was a product of China. Customs stated the following:

> The filling of the quilt shell is, in our view, a simple combining operation. The closing of the quilt shell is nothing more than a simple stitching procedure. The quilting stitching which serves to hold the filling in place and provides a decorative appearance, may be both time consuming and requiring of a certain degree of skill when done by hand. However, (1) the quilting stitching is not sufficiently complex to rise to the status of a "substantial manufacturing or processing operations", and (2) the same quilting stitching is a relatively quick and simple procedure when done by machine.

In this case the stitching of the comforter shell is performed by machine and in accordance with the aforementioned ruling, it is Customs belief that filling a comforter shell with down requires the same level of complexity as filling a quilt shell with polyester wadding. It is a simple combining operation that does not result in a substantial manufacturing operation. As stated above, you argue that filling a shell with down and polyester wadding is substantially different; the technology and skill is more sophisticated in the initial scenario. At this time, Customs, is not prepared to make a distinction between filling a shell with down and filling a shell with polyester wadding. They are both relatively quick and simple manufacturing operations. You provide a very costly figure for the machinery necessary to blow down into a comforter. However, after further investigation, Customs found that the figure cited vastly fluctuated depending on the extra features provided with the machinery. Moreover, the value or the cost of the equipment used to perform the manufacturing operations will not be a persuasive factor in determining whether an article undergoes a substantial manufacturing operation.

You cite numerous rulings as evidence that the subject merchandise is substantially transformed in the United States. One such ruling is HRL 734374, dated April 3, 1992, where Customs determined that the country of origin of vinyl shells used in the manufacture of
waterbed mattresses was the United States. The processing for the goods therein is as follows:
vinyl shells are imported into the United States; foam and fiber are rolled out onto a cutting table and cut; five layers of fiber, a layer of convoluted foam, and a layer of cell foam are sewn together; the foam and fiber assembly is inserted into the vinyl cavity; and, the vinyl cavity is permanently closed with the use of a bonding machine. The processing involved for the merchandise of HRL 734374 is substantially more complex than the processing involved in the instant case. In HRL 734374, layers of foam and fiber had to be laid out and cut in addition to other processing. In this case, down is blown into a comforter shell, the shell is stitched, and sewn shut. There is no cutting involved in the second country. However, there are cutting and sewing operations involved in the country where the comforter shell is produced. Therefore, the facts of HRL 734374 are distinguishable from the instant facts.

You also refer to HRLs 731837 and 732844, dated August 17, 1989 and February 5, 1990, respectively. HRL 732844 confronted the issue of whether surgical instruments machined, finished, and assembled in Pakistan from stainless steel forged instrument blanks produced in the United States undergo a substantial transformation in the United States. HRL 731837 dealt with whether cassette shells imported into the United States in a condition ready for the insertion of the tape underwent a substantial transformation as a result of the insertion. You specifically state the following:

> The processes to which the imported articles are subjected to in the United States do not alter their shape or appearance. Customs has concluded that the insertion of tape into a cassette shell results in a substantial transformation of the shell and the insertion of foam and fiber into a vinyl shell results in a substantial transformation of the shell. Customs should rule in a consistent manner and hold that insertion of down and feathers into a comforter shell results in a substantial transformation of the shell.

Customs is not swayed by your reliance on these particular cases as they are based on the country of origin marking rules of Section 134.35, Customs Regulations (19 CFR 134.35). These cited cases do not apply to textiles and fail to mention Section 12.130, Customs Regulations, which Customs has interpreted as governing country of origin determinations for textiles and
textile products, which are at issue in this case. Consequently, the down comforters at issue undergo their last substantial transformation in the country where the comforter shell is cut and sewn, Hong Kong and/or China.

Accordingly, the imported comforter shells are not substantially transformed when they are used to produce finished comforters in the U.S. Therefore, I [redacted]es, Inc. is not the ultimate purchaser of the imported comforter shells. Rather, the ultimate purchaser is the person(s) who purchases the down comforters at retail in the U.S., and the comforters must be marked to indicate the country of origin "Hong Kong" or "China" to such person(s).

HQ 957472 April 25, 1995 CLA-2 R:C:T 957472 CAB CATEGORY: Cl

HQ 957472

April 25, 1995

CLA-2 R:C:T 957472 CAB

CATEGORY: Classification

RE: Country of origin of down comforters; Section 12.130, Customs Regulations

Dear M

This is in response to your inquiry of January 31, 1995, concerning the country of origin of down comforters. A sample was not provided to Customs for examination.

FACTS:

You are requesting a country of origin determination for a finished goose or duck down comforter under two distinct manufacturing scenarios. In the first scenario, the manufacturing process is as follows: Goose or duck down that has been washed and sterilized in China will be transported to Macao; Comforter shells cut and sewn in China will also be transported to Macao; The comforter shells and down will be assembled in Macao; Finally, the finished down comforter will be exported to the United States. In the second scenario, the manufacturing process is as follows: Imported cotton piece goods will be cut and sewn into comforter shells in Macao. These comforter shells will be filled with washed and sterilized goose or duck down from China in Macao. The finished down comforters will be exported to the United States.

ISSUE:

What is the country of origin for the subject down comforter?

LAW AND ANALYSIS:

Country of origin determinations for textile products are subject to Section 12.130, Customs Regulations (19 CFR 12.130). Section 12.130 provides that a textile product that is processed in more than one country or territory shall be a product of that country or territory where it last underwent a substantial transformation. A textile product will be considered to have undergone a substantial transformation if it has been transformed by means of substantial manufacturing or processing operations into a new and different article of commerce.

Section 12.130(d), Customs Regulations, sets forth criteria for determining whether a substantial transformation of a textile product has taken place. This regulation states these criteria

are not exhaustive; one or any combination of criteria may be determinative, and additional factors may be considered.

Section 12.130(d)(1), Customs Regulations, states that a new and different article of commerce will usually result from a manufacturing or processing operation if there is a change in:

(i) Commercial designation or identity, (ii) Fundamental character or (iii) Commercial use.

(i) The physical change in the material or article;

(ii) The time involved in the manufacturing or processing operation;

(iii) The complexity of the manufacturing or processing operations;

(iv) The level or degree of skill and/or technology required in the manufacturing or processing operations; and

(v) The value added to the article or material.

Section 12.130(e)(1), Customs Regulations, describes manufacturing or processing operations from which an article will usually be considered a product of the country in which those operations occurred.

Section 12.130(e)(1)(iv), Customs Regulations, states that a textile article will usually be a product of a particular country if the cutting of the fabric into parts and the assembly of those parts into the completed article has occurred in that country. However, 12.130(e)(2)(ii) states that a material will usually not be considered to be a product of a particular foreign country by virtue of merely having undergone cutting to length or width and hemming or overlocking fabrics which are readily identifiable as being intended for a particular commercial use.

In the first scenario, washed and sterilized goose or duck down from China will be exported to Macao. Comforter/quilt shells that have been cut and sewn in China will also be exported to Macao. In Macao, both the comforter/quilt shells and the goose or duck down will be combined to result in finished down comforters.

As the comforter/quilt shell is exported to Macao already cut into parts and assembled, in accordance with Section 12.130(e)(1)(iv), it has undergone a substantial transformation in China. The issue Customs must address is whether the processing in Macao results in a substantial transformation. The value added to the comforter shell in Macao is significant and the increased value is due in most part to insertion of the down into the shell. The average cost of down is usually costlier than a comforter shell. There is also a requisite degree of skill involved in filling a comforter shell with down. In order for down to properly impart warmth throughout the entire comforter, the comforter must undergo processing in Macao which involves additional stitching or baffles to prevent the down from shifting to any single area of the article. Finally, the down and the comforter shell lose their separate identity and become a new and different article of commerce after they are combined in Macao. Therefore, in accordance with Section 12.130(d), in the first scenario, the subject article undergoes its last substantial transformation in Macao, the country where the down is inserted into the comforter shell.

In the second scenario, piece goods will be imported into Macao. In Macao, the piece goods will be cut and sewn into a comforter shell. These shells will be filled in Macao with washed and sterilized goose or duck down from China. In this case, the piece good undergo a substantial transformation in Macao in accordance with Section 12.130(e)(1)(iv), as it is Macao, where the piece goods are cut and sewn into a finished comforter shell. Also, as stated above, the insertion of down into a comforter shell results in a substantial transformation in the country where the combining occurred, Macao.

HOLDING:

In both scenarios, the country of origin of the down comforter at issue is Macao.

This ruling is issued pursuant to the provisions of Part 177 Customs Regulations (19 CFR Part 177). The holding in this ruling only applies to the specific factual situation presented and the merchandise identified in the ruling request. If the information furnished is not accurate or complete, or there is a change in the factual situation, this ruling will no longer be valid. In such an event, a new ruling request should be admitted.

Sincerely,

John Durant, Director

Chairman CRANE. Thank you for your testimony, Mr. Hansen.
Mr. Moore.

STATEMENT OF CARLOS MOORE, EXECUTIVE VICE PRESIDENT, AMERICAN TEXTILE MANUFACTURERS INSTITUTE

Mr. MOORE. Thank you, Mr. Chairman.

My name is Carlos Moore, and I am executive vice president of ATMI, the American Textile Manufacturers Institute. We are the national trade association for the textile mill products industry and our members process nearly 80 percent of all the textile fibers consumed by this industry, and we produce and market an entire range of textile goods—from bed sheets to parachute cloth, from yarn to power transmission belts, from denim to surgical towels.

We appreciate the opportunity to speak today on a matter of great importance, the rules of origin to determine the country of origin of imported textile and apparel products. As you noted in your press release outlining the scope of this hearing, some have expressed concerns about extending to other countries the rules of origin approach taken in the NAFTA.

Frankly, Mr. Chairman, the experience of ATMI, which supported NAFTA, has been that the NAFTA rule of origin for textiles and apparel has provided clarity and certainty in this area and is working well. We are pleased that the NAFTA approach, which employs changes in tariff classifications, has become the basis for Treasury's proposals with respect to other countries.

Mr. Chairman, section 334 of the Uruguay Round Agreements Act sets forth new rules of origin for certain textile and apparel products which meet the aims and objectives stated for this hearing.

As an aside, I would like to call attention to the fact that the American Fiber Manufacturers Association, the National Cotton Council, the Amalgamated Clothing & Textile Workers Union, the American Apparel Manufacturers Association, and the National Knitwear and Sportswear Association, which represent the entire spectrum of the American fiber, textile and apparel industry, from cotton growers to garment makers, and account for nearly 2 million U.S. workers, also support the rules of origin contained in the NAFTA and the Uruguay round implementing legislation and the new Customs rules. I understand that these organizations will be submitting a separate statement to that effect for the record.

The new rules of origin are a great improvement over the patchwork of rules they replace, for a variety of reasons. Chief among these are they are more transparent and predictable. They are based on a change of tariff heading, which by international consent is the preferred methodology for determining origin. They will greatly reduce, perhaps even eliminate, great distortions in textile apparel trade data. They more closely conform to the rules of origin employed by almost every other industrialized country than do the old rules. But most importantly, they conform to and better reflect commercial realities than the old rules.

In the time allotted me, I would like to expand on two of the points I have raised, transparency and commercial practice. Customs Regulation 12.130 has been open to a variety of interpretations. As a consequence, Customs has issued scores, if not hun-

dreds, of rulings in attempting to clarify its intent and meaning, some of which have led to court challenges that have been costly and time consuming.

The new rules will avoid future ambiguities. The new rules are to a very great degree simplicity itself. If the good does not conform to the change of tariff heading, it does not gain origin. This will save the Customs Service the enormous burden of issuing rulings and reduce the expense of administering Customs laws and regulations.

With regard to commercial practice, the most controversial aspect of the new rules, comments which you have heard today, is that which makes the country of origin of imported apparel the country in which the pieces of cut fabric were assembled, that is, sewn together, rather than the country in which the fabric was cut into the constituent pieces, which is the old rule.

Mr. Chairman, on behalf of ATMI, I cannot state it any more simply or forcefully: The old rule is wrong, and the new rule is right. In the making of an item of apparel, whether it is a pair of shorts, a pair of pants, a dress, or a coat, the least labor intensive and least costly operation is the cutting of the fabric.

Whether one wishes to measure it in terms of time expended, direct labor input or cost, it is recognized by just about everyone that the assembly of the cut pieces of fabric represents a far, far greater portion of manufacturing of an apparel product than does the cutting of the fabric. In fact, our trading partners in the European Union, Canada, and in nearly every other country all recognize the validity of this principle as they utilize an assembly rule in determining country of origin.

Also, the change to an assembly rule is consistent with the Uruguay Round Agreement itself, which is noted in the Chairman's press release on this hearing, and which called for harmonization of rules of origin.

Imports that will be affected by the cutting and assembly rule change will be those apparel products which are cut in or in many cases allegedly cut in countries, primarily Hong Kong and Singapore, for the single purpose of circumventing quotas.

In these instances, under the old rule, Hong Kong and Singapore had empty quotas which they wanted to fill with garments assembled in China, permitting them to reap the benefits of quota allocation in Hong Kong and Singapore and increase profits by simply cutting the Chinese made apparel. This is a scam which is counter to the spirit and intent of the recently expired MFA and its successor, the Uruguay Round Agreement on textiles and clothing. ATMI is pleased that the revisions to the U.S. rules of origin will prohibit this activity in the future.

I should also emphasize that under the new assembly rule of origin, countries which do the cutting today, primarily again Hong Kong and Singapore, will not have their quotas reduced as a consequence of this. On the contrary, their quotas will continue to grow and will accelerate in growth over the next 10 years. But their quotas will now have to be filled by garments actually made in Hong Kong and Singapore, rather than made in China as has been the case in the past.

In closing, Mr. Chairman, the Treasury Department, we believe, has developed a clear logical approach to the rules of origin which is in the best interests of the U.S. textile industry complex and its nearly 2 million workers, and in our view no further action is warranted.

Thank you.

[The prepared statement follows:]

STATEMENT OF CARLOS MOORE
AMERICAN TEXTILE MANUFACTURERS INSTITUTE

My name is Carlos Moore. I am Executive Vice President of ATMI, the American Textile Manufacturers Institute. ATMI is the national trade association for the textile mill products industry. ATMI's members process nearly eighty percent of all the textile fibers consumed by the United States textile industry and produce and market the entire range of textile goods -- from bed sheets to parachute cloth, from yarn to power transmission belts, from denim to surgical towels.

ATMI thanks the Committee for the opportunity to speak today on a matter of great importance, the rules used to determine the country of origin of imported textile and apparel products. As the chairman noted in his press release outlining the scope of this hearing, some have expressed concerns about extending to other countries the rules of origin approach taken in the North American Free Trade Agreement (NAFTA). Frankly, Mr. Chairman, the experience of the American textile industry and ATMI, which supported NAFTA, has been that the NAFTA rule of origin for textiles and apparel has provided clarity and certainty in this area and is working well. We are pleased that the NAFTA approach, which employs changes in tariff classifications, has become the basis for Treasury's proposals with respect to other countries.

Looking globally, I am pleased to report, Mr. Chairman, that the aims and objectives of this hearing and the study of rules of origin currently underway by the U.S. International Trade Commission have, in the case of most textile and apparel products, already been satisfied by legislation enacted by Congress last year. I refer to Section 334 of the Uruguay Round Agreements Act which sets forth new rules of origin for certain textile and apparel products. These new rules replace those embodied in Customs regulation 12.130 which were promulgated in 1985 and which, as a decade of experience has shown, beyond any shadow of doubt, are confusing, unwieldy and inadequate.

As an aside, I would like to call attention to the fact that the National Cotton Council, which represents the entire spectrum of the American cotton industry from growers to manufacturers, also supports the rules of origin contained in NAFTA and the Uruguay Round implementing legislation, and the new Customs rules. I understand that the National Cotton Council will be submitting a separate statement to that effect for the record.

The new rules of origin for textiles and apparel are a great improvement over the patchwork of rules they replace for a variety of reasons. Chief among these are:

1) They are more transparent and predictable than the old rules.

2) They are based on a change of tariff heading which, by international consent, is the preferred methodology for determining origin.

3) They will greatly reduce, perhaps even eliminate, great distortions in textile and apparel trade data.

4) They more closely conform to the rules of origin employed by almost every other industrialized country than do the old rules.

5) Most importantly, they conform to and better reflect commercial realities than the old rules.

Still, the new rules of origin for textiles and apparel have been met with a great deal of criticism. This criticism is unwarranted and, frankly, indefensible. With your permission, I would like to file with the Committee ATMI's submission to the U.S. Customs Service regarding the new rules. That document will amplify some of the points I just mentioned. In the time allotted to me, I would like now to expand further on two of the points I have raised: transparency and commercial practice.

Customs regulation 12.130 has been, to put it mildly, open to a variety of interpretations. As a consequence, Customs personnel have been required to issue scores, if not hundreds, of rulings in attempting to clarify its intent and meaning.

In addition, there have been court cases challenging some of Customs' rulings, cases in which Customs, that is to say the United States government, has been the defendant. All this has cost an untold number of man hours and a considerable sum of taxpayers' money to enforce. The new rules will avoid future ambiguities. The new rules are, to a very great degree, simplicity itself: if the good does not conform to the change of tariff heading, it does not gain origin. Period. This will save the Customs Service the enormous burden of having to issue ruling after ruling and thereby greatly reduce the expense of administering Customs laws and regulations. I'm certain the Committee will agree that this is a worthy objective.

With regard to commercial practice, the Committee is doubtless aware that the most controversial aspect of the new rules is that the country of origin of imported apparel is the country in which the pieces of cut fabric were assembled -- that is, sewn together -- rather than the country in which the fabric was cut into the constituent pieces, which is the old rule. Mr. Chairman, I cannot state it any more simply or forcefully: the old rule is wrong; the new rule is right.

In the making of an item of apparel -- a shirt, a pair of pants, a dress, a coat -- the least labor intensive and least costly operation is the cutting of the fabric. Whether one wishes to measure it in terms of time expended, direct labor input or cost, it is recognized by everyone in the industry that the assembly of the cut pieces of fabric represents a far, far greater portion of manufacturing an apparel product than the cutting of the fabric does. No rational or coherent defense of cutting as the determinant of origin of apparel can be offered. Common sense and commercial practice will lead one to reject it. In fact, our trading partners in the European Union, Canada and in most other countries all recognize the validity of this principle as they utilize an assembly rule in determining country of origin. Also, the change to an assembly rule is consistent with the Uruguay Round agreement itself which, as noted in the chairman's press release on this hearing, called for such harmonization of rules of origin.

It will doubtless be argued by some that the new rules of origin regarding assembly of garments constitute a trade barrier because they will change the country of origin of some of the nearly $40 billion worth of apparel which the United States imports each year. The new rules do not create a trade barrier, they close a glaring loophole which has been exploited by a handful of exporters for a decade. Except for garments entered under tariff heading 9802 (formerly 807), the vast majority of imported apparel originates in countries in which both the cutting and assembly were accomplished. These imports will be unaffected by the new rule. The only reason to cut fabric pieces in one country and assemble them in another is to gain an advantage unrelated to the manufacturing process.

In the U.S. under tariff provision 9802, fabric is cut in the U.S. and assembled elsewhere (usually in the Caribbean or Mexico) to gain the advantage of reduced duty when the assembled good re-enters the U.S. However, the country of origin in such cases has been and continues to be the country where the pieces were assembled -- not where they were cut. Therefore, 9802 apparel trade will be unaffected by the rule change.

Imports that will be affected by the rule change will be those apparel products which are cut or, in many cases, allegedly cut, in countries like Hong Kong and Singapore for the single express purpose of circumventing quotas. In these instances, under the old rule, Hong Kong and Singapore had empty quotas which they wanted to fill with garments assembled in China, permitting them to reap the benefits of quota allocation and increased profits by simply cutting the Chinese-made apparel. This is a scam which is counter to the spirit and intent of the recently expired MFA and its successor Uruguay Round Agreement on Textiles and Clothing, and ATMI is pleased that the revisions to the U.S. origin rules will prohibit this activity in the future.

I should also emphasize that, under the new assembly rule of origin, countries like Hong Kong and Singapore will not have their quotas reduced -- on the contrary, their quotas will continue to grow. But their quotas will now have to be filled by garments actually made in these countries, rather than in China as has too often been the case.

In closing, Mr. Chairman, the Treasury Department has developed a clear, logical approach to the rule of origin which is in the best interest of the U.S. textile industry complex and our nearly two million workers, and in our view no further action is warranted.

Chairman CRANE. Thank you, Mr. Moore.

Mr. Rangel.

Mr. RANGEL. No questions, Mr. Chairman.

Chairman CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Moore, just so I understand, are you saying there should be quotas on products where there is virtually no U.S. production?

Mr. MOORE. No, sir. I was saying that Hong Kong and Singapore have quotas today. Those quotas have not been filled because U.S. importers have decided that they would rather obtain cheaper products made in China than made in Hong Kong or Singapore.

So in order to exploit those quotas which exist today and are empty, a mechanism has been devised in which the cutting takes place in those countries, but the actual sewing and assembling of the garments is taking place in China. So 95 percent of the production of a piece of apparel is taking place in China, and 5 percent, the cutting, is gaining origin, and that just does not make common sense.

Mr. RAMSTAD. Let me narrow the scope of my question. Why should our country maintain textile import quotas, where both historically and currently there is virtually no U.S. production and where U.S. textile mills, when they are approached by textile firms that perform final processing, have indicated absolutely no interest in producing the product?

Mr. MOORE. Now, if you are referring to the fabric that Mr. Hansen referred to, that is not what we are talking about here. We are talking about apparel production that is primarily——

Mr. RAMSTAD. I understand that, but do you think the United States should maintain textile import quotas where there is virtually no U.S. production, where U.S. mills, when they are approached, have no interest in producing the product? Do you think that in that situation, under those conditions, we should maintain import quotas?

Mr. MOORE. In fact, we have not maintained quotas in those situations.

Mr. RAMSTAD. So you do not think we should impose quotas?

Mr. MOORE. We have quotas on only products that disrupt our market. An imported product can only disrupt our market if it is taking away U.S. production and jobs or is threatening to do so.

Mr. RAMSTAD. So given the conditions I stipulated, you do not believe we should impose import quotas?

Mr. MOORE. No, sir, that is not what I said.

Mr. RAMSTAD. I am asking you, yes or no.

Mr. MOORE. Import quotas are being phased out over the next 10 years. Whether we want to keep them or you want to get rid of them, that is what is happening internationally.

Mr. RAMSTAD. Right.

Mr. MOORE. That is a fact of life, and we recognize that. In some cases, we feel that is not going to be terribly disruptive. In other cases, it will be.

Mr. RAMSTAD. Let me try to ask my question another way. Where there is virtually no U.S. production and when U.S. textile mills have no interest in producing the product, then, given those two conditions, should we maintain textile import quotas?

Mr. MOORE. No. We have taken that position over the years.

Mr. RAMSTAD. I would think so, because, as Mr. Hansen pointed out, I think we all can agree that common sense needs to prevail regarding the rules of origin. The down comforter example you gave defies logic. It is absurd, and any reasonable man or woman would reach that conclusion. I certainly appreciate your response to the question, Mr. Moore, and I appreciate all the witnesses who are here today.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

I want to thank all the witnesses for their testimony.

Let me begin by going back to something that my colleague asked about earlier, and that is why in the GATT implementation bill we have the rule of origin in the first place?

I represent a district that has 50,000 textile and apparel workers. We have been very concerned and still are concerned about the GATT Agreement as it related to the workers and the industries that are in my district, and I think there are many other people who are part of the Textile Caucus, a very large caucus in the Congress, who have equal concerns. The concern really has to do with the multifiber arrangement which has been around for a long time. The GATT Agreement is phasing that out, so that at the end of 10 years there will not be any quotas. They will be phased out under the GATT Agreement.

What that means, according to some who have analyzed this, is that of the 2 million people who work in this industry now, probably a half million or more will not be working in that industry at the end of the 10-year period, and so it will have an impact on a lot of companies, a lot of individuals, and a lot of areas that rely on that kind of employment.

The rule of origin was an attempt by Mr. Cardin, who is a member of the committee, to conform the rule of origin of the United States to that of other nations. It was pointed out in the debate that what was going on was that we were using a rule of origin that basically said the rule of origin was where goods were cut and not where they were assembled.

What we learned was that that was something that maybe made a lot of sense when goods were cut with scissors, but as a result of the laser technology, that generally 5 percent or less of final value of the item was involved in cutting or that particular process, and that the substantial amount of value was added as these goods were assembled, often by hand, sewn, and so forth.

So the attempt was then to conform in the GATT legislation the rule of origin to the same that Mexico and Canada and the European community use, which basically says that the rule of origin is where the goods are assembled, and not where they are cut.

We thought then this was important, and 24 out of the 36 people on the Ways and Means Committee voted for this. It went to the Senate, and Mr. Zimmer's question was why, if it failed in the Senate Finance Committee, was it included? Actually, there was a tie, a 10-to-10 vote, and consequently that was the reason for the failure. It was thought to be important enough for the purposes of ensuring that some sections of our country and our economy, that it was added as a part of the Uruguay round. It was also added be-

cause it was necessary to get enough votes to pass the Uruguay round and to have the GATT actually implemented.

The situation Mr. Hansen talked about was really not a function what went on with respect to that particular rule of origin. In fact, it comes about because of some of the regulations that Customs is now doing, I think, specifically that were excluded from the assembly rule as it related to the rule of origin in the GATT round, but not necessarily what is going on now with Customs and with the process that they are involved in.

I think that this particular rule of origin is consistent with the obligations under the Uruguay round which state that rules of origin should provide for the country to be determined as the origin of a particular good where the last substantial transformation has been carried out. I think that is appropriate.

I would like to take my last 30 seconds to ask a question I think is relevant to this, and this is a question to Mr. Moore who talked a good bit about this. We talked about the fact that this is conforming legislation to the extent that the European community, Canada, and other countries utilize an assembly rule of origin. You talked about Hong Kong and Singapore who were involved in quota circumvention by the Chinese, and you talked a good bit about how that happened.

What kind of rules of origin do Hong Kong and Singapore have? Do they have a rule of origin which suggests that the garment needs to be cut in order to be classified as the country of origin?

Mr. MOORE. As a matter of fact, Congressman Payne, those countries also have a rule of origin that requires cutting and sewing to confer origin on a product in their own country, for imports coming into their country.

In fact, I could read you the Hong Kong Trade Department's notice to exporters which they issued fairly recently, and they describe the U.S. rule of origin. "Under the U.S. rule—the old rule—in general cutting is the origin conferring process." This is less restrictive than existing Hong Kong origin rules which require both cutting and assembly to be done in order for a good to gain origin in Hong Kong.

I understand a similar rule exists in Singapore. I do not have documents regarding that.

Mr. PAYNE. So we are not only conforming to the European community, to Canada and Mexico, but also to rules that Hong Kong and Singapore——

Mr. MOORE. Hong Kong itself follows, yes, sir.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Chairman CRANE. I want to thank all the panelists for their participation today.

With that, the subcommittee stands adjourned.

[Whereupon, at 6:19 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF THE AMERICAN APPAREL MANUFACTURERS ASSOCIATION

The American Apparel Manufacturers Association (AAMA) is the trade association of the U.S. apparel industry, representing approximately 70 percent of the U.S. production. Our members make everything from socks to caps, from underwear to shirts and sweaters, to suits and overcoats. While the industry is large, most of the companies are relatively small. Three-fourths of our members have sales under $20 million and more than half have sales under $10 million. Our members are the source of more than 700,000 manufacturing jobs. In total there are approximately 1,000,000 apparel manufacturing jobs in the U.S. and almost every state has some apparel employment. Nineteen states have more than 10,000 apparel jobs and eight of those have more than 50,000 jobs. Approximately 40% of American apparel workers are minorities and 90% are women.

Last year Congress enacted legislation, Section 334 of the Uruguay Round Agreements Act, which sets forth new rules of origin for certain textile and apparel products. These new rules replace those contained in Customs Regulation 12.130 which were promulgated ten years ago and were difficult to use, confusing, and inadequate. AAMA strongly supported the legislative change of the rule of origin contained in Section 334.

The new rule is that the country of origin of imported apparel is the country in which the pieces of cut fabric were assembled – that is sewn together – rather than the country in which the fabric was cut into component parts (which is the old rule). We supported this change because:

- In apparel production, cutting requires very little labor and time (less than 5 percent) while assembly (sewing and related operations) require the remaining labor, time and resources in the production process.

- The most common origin rule followed by our major trading partners is assembly, not cutting - although Canada requires both cutting and assembly to confer origin.

- A change to an assembly rule of origin was consistent with the Uruguay Round Agreement that countries will seek to harmonize their origin rules. It does not violate our GATT obligations as importers claim, but, in fact it does just the opposite by making the U.S. rule conform with others, including the European Union, Canada, Japan, all the major apparel importing countries.

- An assembly rule of origin closes a serious loophole whereby foreign countries such as Hong Kong, Singapore and Taiwan exploit the cutting rule of origin and cause damage to the U.S. industry and its workers. These countries send cut apparel pieces to lower wage countries - primarily China - where the pieces are sewn into apparel and then shipped to the U.S., not as products of China, but of the country where the cutting took place. This practice has, in effect, permitted China to ship apparel to the U.S. far in excess of its quota.

- Importers who are currently sourcing Chinese-made goods from countries where the goods are cut can continue to source goods from those countries. The only change is that such goods have to be actually made in those countries and can no longer be assembled in China. For example, Hong Kong's apparel quota levels and growth is unaffected by this change. Hong Kong will have to be the producer of the apparel, rather than China.

In summary, the new rules of origin for textiles and apparel are a great improvement over the rules they replace because they are more transparent and predictable than the old rules and better reflect commercial realities.

STATEMENT OF THE AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS

The American Association of Exporters and Importers (AAEI), founded in 1921, is a national organization comprised of approximately 1,200 U.S. company-members engaged in all aspects of international trade. Importing and exporting members, shippers, customs brokers, freight forwarders, and other member service firms interact daily with the U.S. Customs Service, making AAEI one of the closest observers of Customs operations. AAEI has also been active in Customs issues and has testified on the U.S. Customs Service budget authorization and Customs Compliance and Modernization Act. The Association also comments regularly on proposed Customs regulations. On behalf of AAEI's members we submit the following comments in response to the above-referenced Proposed Rulemaking.

AAEI supports providing "greater certainty and predictability for both the trade community and the Customs Service in making country of origin determinations" or providing "rules that are more objective and transparent." While rules of origin based on a shift in Harmonized Tariff Schedule number may achieve those goals, Customs proposal to apply NAFTA rules of origin to all goods imported into the U.S. is premature. Although AAEI supports objective rules, it has several reservations about changing the rule of origin for all imports into the U.S. at this time, based principally on pending international efforts to harmonize rules of origin and the cost to businesses if the U.S. changes its rules.

Uruguay Round Trade Agreements

The U.S. agreed to address international harmonization of origin rules in the "Agreement on Rules of Origin" as part of the Uruguay Round of Trade Agreements. That agreement establishes a Technical Committee on Rules of Origin under the auspices of the World Customs Organization (WCO) to study harmonization of rules of origin, including the rule based on a Harmonized System tariff-shift. AAEI understands that the WCO has already begun work on a harmonized rule pursuant to the Uruguay Round agreement.

The U.S. should avoid implementing a rule of origin for all imports until the WCO finishes its work and a harmonized rule of origin is adopted by the World Trade Organization (WTO), the successor to GATT. The U.S. has worked long and hard on the multilateral trade agreement, and to prematurely adopt a broad U.S. rule in the face of WTO efforts would violate the spirit of the Uruguay Round trade agreements and undercut the multilateral trading system the U.S. has worked so hard to foster.

Cost to U.S. Business

Moreover, requiring U.S. businesses to adapt to a new rule of origin now and then again in 2-3 years does not make economic sense and will be impracticable as well. It is possible that if the Proposed Rule is implemented a company could have three different countries of origin for its product, applying three different rules, within a period of three years, without changing the product or its source.

In addition to the time and costs involved in changing packaging and retraining employees, businesses would face the prospect of penalties for mismarked goods, especially in the transition periods. Customs too would face retraining costs and work delays as its personnel became familiar with the new rules. Not all Customs personnel deal with marking issues on Canadian and Mexican goods on a daily basis and even those that do will not be experts on the application of tariff-shift rules in the near future. Customs' task

is even more daunting in the light of implementing the NAFTA, the Customs Modernization and Informed Compliance Act of 1993 and the Uruguay Round Agreements Act.

U.S. business and Customs should be allowed time to become accustomed to the NAFTA rules before they are applied to all imports. Customs loses nothing by maintaining the existing rules for preferential and non-preferential trade for two to three more years.

NAFTA Rules Reflect Political Compromise

If the WTO were to eventually adopt the U.S. tariff-shift approach, it is unlikely that it would be adopted without change to the NAFTA rules, which were developed in the course of politically charged trade negotiations and which may not necessarily reflect commercially recognized changes in origin. The NAFTA rules of origin were developed for and apply to a preferential trade program, where imports are given a duty preference if they qualify, which is not necessarily a desirable precedent for a non-preferential rule. Preferential trade agreements have specific public policy, political and economic goals of the parties involved, which may be at odds with, or at least different from, the general trade policies of each party.

NAFTA's rules of origin reflect political pressures and compromise and special interests of the three NAFTA parties. AAEI is certain that these interests will not totally coincide with the realities of trade with non-NAFTA countries. To impose NAFTA based rules on all products from all countries at any time would be impractical.

Judicial Precedent

In its prior Notice of Proposed Rulemaking, Customs recognized that the U.S. rules of origin "reflect tests and criteria developed through the years in judicial decisions," and that the "current judicially developed test" is the "substantial transformation" rule, 53 Federal Register 141 (Jan. 3, 1994). There is no question that the courts have adopted the "substantial transformation" rule of origin as the rule of origin for imports into the U.S. absent a specific Congressional enactment to the contrary. The courts have also used the rule in determinations of a product's origin under trade preference programs such as GSP. See Madison Galleries v. U.S., Section 70 F.2d 627 (CAFC 1989).

While Customs may argue that the judicial decisions result "in a lack of predictability" and that a tariff-shift rule of origin may be just another means for determining whether a substantial transformation has occurred, existing judicial precedent should not, be overturned by administrative rulemaking.

Customs cites specific court cases to support its belief that the tariff-shift rules incorporate the concept of "substantial transformation" as defined by the courts. The court cases cited however are used only to support a proposed tariff-shift from the product at issue in the case, (e.g. Uniroyal - shoes, National Juice - orange juice), rather than the principles of substantial transformation that the cases espouse, such as transformation resulting in a product with a new name, character or use. Additionally, Customs refuses to follow or ignores judicial decisions that do not support Customs proposed tariff-shift rules, like Midwood Industries, Inc. v. United States, 313 F.Supp. 951 (Cust.Ct. 1970); Madison Galleries v. U.S., 870 F.2d 627 (CAFC 1989); and Belcrest Linens v. United States, 741 F.2d 1368 (Fed. Cir. 1984).

Customs has not offered any proof that each of the proposed tariff-shift rules incorporates the judicial interpretation of substantial transformation. Since there is no statutory, judicial or international mandate to propose or implement these rules unilaterally, it is premature and senseless to force these upon U.S. business at this time.

U.S. trade preference programs such as GSP and CBI, were created by statute. Congress held hearings, accepted public comment and fully considered the rules for eligibility for the programs. Any changes to the origin rules for U.S. preference programs should also be subject to the same scrutiny.

Textile Rules of Origin

AAEI previously commented on the specific proposed changes to the rules of origin for textiles. Since the time of those comments, Congress has mandated that new rules of origin for textiles and apparel become effective on July 1, 1996. Customs is now drafting final rules to comply with Congress' direction. The draft rule issued by Customs included a tariff-shift requirement that varies from the above-referenced proposal, the application of which, in many cases, would result in a different country of origin for the same product undergoing the same processes. AAEI expects that Customs is not seriously considering the unilateral imposition of origin requirements that will change next year. At a minimum, the new origin rules mandated by the Uruguay Round Agreements Act, P.L. 103-464, should be given precedence and the existing rules of origin for imports of non-NAFTA textiles and apparel should not be changed until July 1, 1996.

Delayed Effective Date

AAEI finds the proposed delayed effective date of "90 days after publication of that final rule document in the Federal Register," in light of the above comments to be totally inadequate. As stated above, the rule should not be implemented unilaterally by the U.S. However, should Customs ignore the wishes of U.S. business and issue a final rule prior to a multilateral rule, the effective date, should be delayed, at a minimum, for one year. Businesses need that time to ensure continued production and minimal disruption.

Conclusion

AAEI believes that this is not the time for the U.S. to unilaterally change the rules of origin for all imports into the U.S. The WTO, WCO and the U.S. are already committed to harmonizing rules of origin for trade. A change now would violate the spirit of the multilateral trade agreements ratified by the U.S., cause unnecessary costs and confusion to U.S. business and Customs, ignore judicial precedent and adversely affect many existing U.S. statutory trade programs.

At a minimum, AAEI requests additional congressional hearings be held on the proposal, and its implementation delayed until the WCO has completed its work on a harmonized rule. There is no mandate, judicial or statutory, to implement these rules, now or in the future. It is just plain good sense to work toward implementation of harmonized rules worldwide rather than attempting to unilaterally impose a new rule on all U.S. international business. In the interest of U.S. importers and exporters the effective date of any new rules of origin should be set through a multilateral consensus.

Rules of Origin

Written Testimony by the *American Electronics Association* Submitted to the House Ways and Means Committee Subcommittee on Trade Following Public Hearing of July 11, 1995

July 25, 1995

The American Electronics Association (AEA) is pleased to provide testimony on the important and timely topic of rules of origin. AEA consists of some 3,000 member companies whose products include computers, semiconductors, analytical instrumentation, aerospace equipment, and telecommunications equipment.

Members of AEA have a large stake in the outcome of policy and regulatory decisions which affect the manner in which the origin of goods is determined. Our member companies operate in a complex, ever-changing global environment characterized by a heavy dependence on international sales, globalized multi-stage manufacturing, and worldwide sourcing of materials. Origin rules that fail to fully account for this environment can disrupt trade, compel uneconomical investment decisions, and create costly administrative burdens. In this circumstance, disruption and burdens can occur to the extent that marking, documentary declarations, or any other origin-related requirements compel business to identify the country of origin of a good.

To prevent negative outcomes, AEA supports non-preference origin rules that foster administrative ease, consistency and non-obstruction of trade, and which are investment- and economic policy-neutral. These goals are supported by many in the US government, as reflected by US support for the Uruguay Round Origin Rules Agreement and the Treasury Department's desire to streamline origin determinations for all non-preferential purposes. At first glance, one might conclude that a "harmonic convergence" prevails on origin-related goals. Such is not the case.

Current efforts by the Administration in the area of non-preferential origin rules are fragmented and threaten more burdensome regulatory requirements. At the Treasury Department, efforts to implement and expand the use of new, overly-restrictive origin rules are promising more administrative complexity and higher business costs, given their failure to conform fully with the historical origin criterion of substantial transformation. In addition, the rules do not appear to have the agreement of all NAFTA parties, despite the fact that they have already been implemented for NAFTA purposes. Meanwhile, at the request of the Office of the United States Trade Representative, the International Trade Commission is appropriately conducting a policy-neutral Section 332 study on rules of origin in a WTO context, an exercise that may well

recommend rules that differ significantly from Treasury's rules in both structure and detail.

In short, the Administration is moving toward a broad adoption of burdensome Treasury Department rules while simultaneously studying ways to supersede them with new WTO rules. AEA submits that this approach is not only antithetical to regulatory reform, it sets a dangerous precedent for implementing rules before the formulation of sound policy goals pursuant to US commitments in the Uruguay Round.

These disjointed efforts are in desperate need of a rein. To create cohesiveness, AEA believes there must be a process of careful coordination between business and concerned government agencies. This process should take place in the context of the Section 332 study and address the issues discussed below.

Use of Substantial Transformation.

AEA believes that non-preference origin rules must firmly rest upon the long-standing origin criterion of "substantial transformation," which the US courts have consistently interpreted as a change in name, character or use. Absent this foundation, the development of origin rules is destined to result in burdensome rules anchored in arbitrary economic goals and/or political caprice.

The Treasury Department's development of new rules is not sufficiently grounded in substantial transformation. On January 4, 1994, two Treasury Department notices involving origin rules were published in the Federal Register. One notice implemented non-preferential origin rules applicable to NAFTA trade (known as the "Part 102" rules), pursuant to Annex 311 of the NAFTA. The second notice proposed to expand these rules to all US trade, and it was followed by proposed modifications to Part 102 in a Federal Register notice dated May 5, 1995. The Part 102 rules employ classification changes, simple assembly, essential character tests and other criteria to establish the origin of products. While the use of a classification-based system is laudable, Treasury has sought to establish the rules as the basis for substantial transformation rather than rely upon substantial transformation as the justification for the rules' existence. Indeed, in the May 5 notice, the definition of substantial transformation and all related references have been expurgated from the rules.

This approach permits "the tail to wag the dog." It allows the Part 102 rules to exist without an overarching policy direction, which substantial transformation provides. Rather, the approach uses the Part 102 rules to drive the definition and application of substantial transformation as found in other regulatory contexts, resulting in an arbitrary, undisciplined, unpredictable and unprincipled process. This is not unlike drafting legislation based on regulatory requirements--rather than passing a statute first and then writing the regulations to implement it.

AEA does believe that Treasury's intent to create efficiency and consistency through mechanical rather than wholly interpretive origin rules carries potential for success, provided all such rules

reflect the totality of court-defined substantial transformation criteria. For over half a century, the courts have generally agreed that substantial transformation means a change that results in a new or different article (that is readily involved in trade) having a distinctive name, character or use which persons might well wish to buy or acquire for their own purposes of consumption or production. Clearly, it is not the cost or process that brings about the change, nor is it the number or origin of constituent materials involved that is pertinent. Rather, it is the commercial meaningfulness of the change to actual and prospective buyers that is germane to determining the non-preference origin of goods.

On this basis, we wholeheartedly support appropriate classification-based rules linked to the Harmonized System (HS) as the primary method for establishing the origin of products. The Part 102 rules, however, contain classification-based requirements that specify changes greater than those required under substantial transformation precedents. These rules are frequently more difficult to satisfy than the similar NAFTA preference rules, which were designed to ensure that a NAFTA tariff preference was granted only to goods substantially transformed within NAFTA with adequate levels of NAFTA commercial input. The Part 102 classification-based rules fail to recognize that substantial transformation also occurs in a non-preference context at much lower levels of change--often from a change within the same classification. Any non-preference rules must recognize these facts.

AEA offers a solution to this problem. A single classification-based system should be established that uses the definition of substantial transformation and its criteria to determine the origin of products. Such a system should provide for mechanical determinations of origin based on changes between and within HS classifications. To the extent origin changes take place within an HS classification, the system should specify those changes through the use of a classification-based format involving shifts from "Column A" descriptors to "Column B" descriptors. This approach is captured in an easy-to-use origin determination template that was provided by AEA to the Treasury Department last year (see AEA's 11/29/94 submission to Treasury, attached). To date, the Part 102 rules do not incorporate this simplified and objective structure for determining origin.

To accommodate those few instances where origin cannot be determined under a single classification-based system, the use of supplementary rules is appropriate, provided they are based on the definition and related criteria of substantial transformation. The "simple assembly" and "essential character" criteria in the Part 102 rules do not fit this bill. Use of these criteria revokes the "change in name, character or use" standard established by the courts in defining substantial transformation. The thrust of the court standard is to establish the origin of products based upon commercial changes rather than measures of commercial input. The essential character and simple assembly tests, by contrast, appear to be an indirect means to use an article's origin content--rather than commercial changes--to determine its origin. Moreover, the subjectivity and arbitrariness of these criteria make them highly difficult to administer. The essential character test is wide open to interpretation. The simple assembly rule, with its "five or fewer pieces" requirement, augurs a logistical nightmare for companies and government authorities alike

through the counting of pieces on products and assemblies.

In sum, by conflicting with substantial transformation, the Part 102 rules mandate origin determinations that are both different and more restrictive than those currently used in the ordinary course of trade. If expanded to all US trade as proposed, the rules will compel AEA members to spend millions of dollars to change origin tracking systems, retrain employees worldwide, modify manufacturing processes, remark goods and solve problems related to third party suppliers (see attached AEA submission to Treasury dated 7/8/94, pages 12-17, for examples). The rules are also likely to require greater effort by US Customs to interpret and enforce those laws and regulations that incorporate origin-related elements.

AEA also notes that non-preference origin rules *per se* should not be used as the sole controlling factor in the administration of antidumping measures or other commercial policy instruments. Such use would fuel demand for onerous origin rules that distort substantial transformation with economically-driven tests based on material content, essential components, or processing levels. For example, US antidumping measures are currently rooted in a fact-specific rather than an origin-based approach. To change the current system into a more origin-based regime would likely result in economically rigorous--and, hence, administratively burdensome--origin rules that would apply broadly to nonpreferential trade. While most trade is not subject to antidumping measures, companies would have to suffer the heavy burden of complying with such broadly-applied rules in any case.

Timing

Any changes to non-preference origin rules should take place with adequate transition time and with a view toward achieving a final work product prior to implementation. Quick transition times and iterative implementations of unfinalized rules can impose a major burden on companies and government authorities alike.

AEA's members are highly concerned over the timing associated with the implementation of the Part 102 rules. The US seems to have instituted the Part 102 origin rules without full agreement and adoption by the other NAFTA partners. Further, the US continues to propose expansion of this new regime to all US trade, even though they will be preempted by WTO rules a short time later.

As indicated, changes to origin rules can impose a staggering expense on companies. It strains all credulity to think that the US government would: 1) impose additional expense on US companies via the Part 102 rules without reaching agreement and adoption of harmonized rules with its NAFTA partners and; 2) seriously consider a significant increase in this expense just prior to the start of the WTO harmonization work program which, in turn, will very likely result in more change and associated expense.

Some government officials have argued that the US must have already-enacted working origin

rules to maximize US leverage in the WTO harmonization exercise. We disagree. AEA believes that US success in the harmonization program is contingent upon agreement between industry and the US government on a comprehensive set of proposed rules. Without such an agreement, the US position in the WTO will be marred by controversy, substantially weakening US negotiating leverage with the many WTO member governments that will surely have the backing of their respective industries.

A number of officials have also claimed that the US needs expanded implementation of the Part 102 rules in the near-term because it will take longer than the three-year period specified in the Uruguay Round origin rules agreement to implement the WTO rules. Again, we disagree. There is no guarantee that the work program itself will consume more than three years, and the government has presented no objective measures to indicate how much longer than three years an implementation of the work program results might require. As evidenced by the government's current efforts, regulatory implementation could follow shortly after the work program is complete.

Whatever the timing, AEA members would experience compounded disruption as the result of expanded implementation of the Part 102 rules followed by implementation of the WTO rules. Such disruption would occur because, as already acknowledged, the WTO rules are likely to differ significantly from the Part 102 rules. The result is that AEA member companies would have to make costly changes to operating systems twice. While such disruption might be mitigated somewhat by a longer period between differing implementation dates, any multiple implementations will lead to major expense for business and, we believe, for the US government as well.

Recommendations

For the reasons stated, AEA believes that the Congress should take action to ensure:

- A withdrawal of the NAFTA Part 102 rules, and their proposed expansion to all US trade.

- Use of the ongoing Section 332 study as a basis for government/industry coordination on the development of proposed rules for the WTO harmonization program. This process should result in proposed rules that conform completely to substantial transformation precedent, meet the needs of US traders, have the consensus of all NAFTA parties and, to the extent possible, are not designed to achieve commercial policy objectives. AEA is not opposed to the use of the Part 102 rules as a baseline for this process, provided they are not implemented.

- A prohibition on US implementation of a new nonpreference origin rule regime until the WTO harmonization work program is completed. If the US proceeds with such a regime before completion of the WTO program, it should not do so

until a one-year transition period elapses following completion of the Section 332 study, finalization of the US position for the WTO program by USTR, and agreement on such rules by our NAFTA partners. (NOTE: This approach, while certainly less attractive than a post-WTO program implementation is far better than an expansion of the existing Part 102 rules to all U.S. trade since it will allow time for proper consultation between interested parties and enhance prospects for development of rules that comport with substantial transformation precedents to the greatest possible degree.)

In closing, AEA believes that all private sector and government parties can and must work together on an equal "win/win" basis to achieve a viable, comprehensive set of proposed rules for the WTO harmonization program. Such cross-sectoral coordination is imperative if the US is to optimize its leverage in the complex and inherently political negotiations that are sure to take place in the WTO program.

STATEMENT FOR THE RECORD

CARPENTER CO.

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

HEARING ON RULES OF ORIGIN

JULY 11, 1995

Carpenter Co. of Richmond, Virginia applauds Representatives Crane and Rangel and the entire Subcommittee on Trade for their perspicacity and judgment in holding hearings on an issue that has steadily become one of the most crucial for American industry and, in particular, for the industry in which Carpenter plays a major role: home textiles.

As Representative Crane remarked in his opening statement, "ideally, effective rules of origin are simple and transparent and ultimately serve as a stimulant to increased trade and investment." Sadly, the rules of origin for imported merchandise as they are currently interpreted by the U.S. Customs Service are neither simple nor transparent. And, as witness after witness has testified before this subcommittee, the rules have "stimulated" only frustration and disappointment in those industries and individual companies compelled to conduct business under them. Carpenter Co. appreciates this opportunity to voice for the record its dissatisfaction with an unwieldy, inequitable—and occasionally irrational—system for determining the origin of imported goods.

Carpenter Co. is a privately owned company that began operations as a producer of urethane foam and comfort cushioning products in 1948. The company has grown and prospered during the intervening years, expanding its operations into 26 states. Company Headquarters are located in Richmond, Virginia, while its Consumer Products Division operates plants in Riverside, California; Altoona, Pennsylvania; Taylor, Texas, and Russellville, Kentucky. In addition, Carpenter has invested over $ 5 million in feather and down processing equipment in Pennsylvania and California and another $ 2-3 million for the special equipment required to fill comforters and pillows with the processed down and feathers. The plants of the Consumer Products Division produce synthetic bed pillows and comforters, feather and down bed pillows and comforters, foam bed pillows and mattress pads, synthetic fiber mattress products, and synthetic and natural craft fiber products. Carpenter's products are distributed through leading department stores, catalogues, and specialty stores and shops throughout the United States, Canada, and Mexico. The

company now employs approximately 5,000 people in North America.

There are now no less than *six* discrete (and often entirely inconsistent) regulatory regimes for determining the origin of imported goods: (1) the current "substantial transformation" standard for textile products embodied in the Customs Regulations, 19 C.F.R. § 12.130(b); (2) interim NAFTA "tariff-shift" rules of origin codified in the regulations at 19 C.F.R. § 102 *et seq.*, (3) proposed "uniform" rules of origin, extending the interim NAFTA tariff-shift rules to *all* imported products, not just those of Canada and Mexico, published in the FEDERAL REGISTER on January 3, 1994; (4) proposed *amended* interim NAFTA rules of origin, published in the FEDERAL REGISTER on May 5, 1995; (5) proposed *amended* "uniform" rules of origin, also published in the May 5th FEDERAL REGISTER; and (6) proposed "Breaux/Cardin" rules of origin for textiles and apparel, published in the FEDERAL REGISTER on May 23, 1995. The *piece de resistance* can be found in the Agreement on Rules of Origin, an annex to the Uruguay Round Agreement which created the World Trade Organization (WTO) and to which the United States is a signatory. The WTO Uruguay Round Agreement calls for the creation of a committee to develop rules of origin with global application to WTO member states.[1]

Thus, in a comparatively short period of time, American industry is compelled to walk a gauntlet of starkly different, sometimes contradictory, complicated, and often inconsistent regulatory origin regimes. Carpenter can be forgiven for joining the chorus of witnesses before this subcommittee who respectfully ask Mr. Simpson, Mr. Lang, and Mr. Banks: where are the simplicity, clarity, and transparency in this muddled quagmire of administrative obfuscation?

U.S. Customs' treatment of two of Carpenter's most important consumer products, down-filled comforters and down-filled pillows, perfectly exemplifies all that is wrong with the current (and proposed) systems of determining origin. In the case of its down-filled comforters, Carpenter imports downproof comforter shells from the Far East and subjects them to blow-and-fill operations in the United States, using imported or domestically-produced down and/or feathers that the company also extensively processes in this country. In the case of its down-filled pillows, Carpenter imports downproof greige *fabric* from the Far East, ships it to a fabric finisher for bleaching and other finishing processes, cuts and sews the domestically-finished fabric into pillow shells (or ticks) in its Altoona, Pennsylvania plant, and then subjects the finished ticks to blow-and-fill operations at its Riverside, California, Altoona, Pennsylvania, and Taylor, Texas plants to create the finished down-filled pillows.

Because the comforter shells are not imported from Mexico or Canada, the NAFTA rules of origin do not apply. The "substantial transformation" standard set out in 19 C.F.R. § 12.130(b) thus controls the determination of origin. The issue becomes: has Carpenter's imported shell been "substantially transformed" (*i.e.*, changed into a new and different product, with a new name, character, or use) by the blow-and-fill and sewing operations performed at the company's plants in the United States? Or is the finished comforter a product of the country from which the shell was obtained? The Customs Service does not seem to be able to make up its mind. In a New York marking ruling issued to another company on July 22, 1994 (NY 899334), the Service held that "the imported shells are substantially transformed into down comforters as a result of the U.S. processing . . . ." Five months later, on December 12, 1994, Customs Headquarters

[1]Article 2(c) of the WTO Agreement on Rules of Origin requires that, during the interim period in which global rules of origin are being developed, rules of origin promulgated by individual member states "shall not themselves create restrictive, distorting, or disruptive effects on international trade." The "Breaux/Cardin" textile and apparel rules of origin create precisely those effects—and, ironically, were codified in the very statute implementing the WTO Uruguay Round Agreements.

issued a determination (HQ 956320) on the same product. It found that "[t]he filling of the shell is, in our view, a simple combining operation. . . . Accordingly, the imported comforter shells are not substantially transformed when they are used to produce finished comforters in the U.S." Four months later, on April 25, 1995, Headquarters again reviewed the origin determination of down comforters. In HQ ruling 957472, the Service held that "the insertion of down into a comforter shell results in a substantial transformation in the country where the combining occurred . . . ." Where are the simplicity, clarity, and transparency in these determinations?

Application of the NAFTA rules to down comforters does not clarify but only further muddies the origin issue. Under the substantial transformation rule (at least as that rule was applied by the Service in December, 1994), Carpenter's finished comforters, filled with down in the United States, are deemed a product of the Asian country in which the shells were created and must be marked as "made in" that country. Under the NAFTA rules, however, filling the shells with down constitutes a "tariff shift," and Carpenter's finished comforters are deemed to have originated in the United States. Thus, *the identical comforters*, if sold in the U.S. market, must be marked as "Made in Macau" or "Made in Hong Kong" and if sold in Canada or Mexico, are deemed products of the United States under NAFTA. Does such a result make any sense at all?

The origin rule in Customs' May 5, 1995 proposed "uniform" regulations provides no relief. To the contrary, the proposed regulations add yet another layer of incomprehensibility. In the proposed rules, Customs calls for recognition of the tariff shift from shell to comforter—but only for shells filled with down or feathers. Thus, even those comforters destined for Carpenter's U.S. market would be deemed products of the United States (a laudable improvement); however, other companies producing comforters filled with material other than down or feathers would continue to suffer the anomalous results discussed above.

While Carpenter applauds the tariff-shift result in the proposed "uniform" origin rules and proposed "amended" NAFTA origin rules, it is a short-lived improvement indeed. Notwithstanding that these proposals have yet to take effect, an undeterred duo of legislators has presented the industry with yet another rule for determining the origin of textile and apparel products: section 334 of the Uruguay Round Agreements Act. This provision entirely reverses the manner in which Customs determines the origin of textile goods from where product components are cut from fabric to where those products are assembled into the finished good. Moreover, the statute creates an impenetrable "special rule"—as if there were not a sufficient supply of rules to occupy the importer already—that Customs has again managed to misinterpret in such a way that Carpenter's finished comforters (fabric from China, shells produced in Macau or Hong Kong, finished comforter blown-and-filled and sewn in the United States) must, in every instance, be deemed *products of the country that produced the fabric*! We have finally been presented with the simplicity and transparency Mr. Simpson repeatedly stressed in his remarks before the subcommittee: the "Breaux/Cardin" rule, as filtered through the irrational prism of Customs' proposed implementing regulations, is simply and transparently ludicrous.[2]

The circumstances surrounding the determination of origin for Carpenter's down-filled pillows only underscore the Alice-in-Wonderland quality fostered by this plethora of regulatory regimes. In the case of down-filled pillows, Carpenter imports the greige downproof *fabric*, ships it to domestic finishers for bleaching, dyeing, and other finishing processes, cuts and sews, *i.e.*, domestically manufactures, the intermediate product (a

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[2]Carpenter Co. has filed comments in opposition to Customs' interpretation of the "Breaux/Cardin" rule of origin. Customs' promulgation of final regulations is currently pending.

pillow shell or "tick") at its Pennsylvania facility, and then blows-and-fills and sews the finished pillow at its California, Pennsylvania, or Texas plant. Mysteriously, the down-filled pillow is treated less preferentially than the down-filled comforter. Both the NAFTA interim rules, the proposed amended NAFTA rules, and the proposed "uniform" rules contain provisions that disallow an origin-conferring tariff-shift *if the product starts as fabric*. The net result is that a pillow shell *made in Hong Kong* from Chinese fabric and blown-and-filled with down or feathers in the United States will be deemed a product of the United States, while a pillow shell *made in the United States* from Chinese fabric and, like its Hong Kong counterpart, also blown-and-filled with down or feathers in the United States will be deemed a *product of China*! How does one explain that dichotomy to workers who are compelled by their own government to sew "Made in China" labels into American-made pillows?

The downproof fabric needed to produce Carpenter's comforters and pillows is produced only in China, India, and Germany, and the German product is prohibitively expensive. Carpenter has actively canvassed U.S. fabric producers in order to obtain U.S.-made downproof fabric—to no avail. Domestic fabric producers are simply not interested in making this product. The upshot of Customs' erroneous interpretation of the "Breaux/Cardin" rule of origin is that every comforter and pillow shell and every comforter and finished pillow, if made with Chinese greige fabric, will be deemed of Chinese origin. The 1996 quota for Chinese shells and fabric is woefully insufficient to meet the needs of U.S. manufacturers. Shells and comforters made in Hong Kong, Macau, and other countries will be excluded from the United States, because under Customs' bizarre interpretation they will all be subject to Chinese quota. We are then faced with the ludicrous prospect of American plants barred from making American products because of restraints needlessly placed upon goods that *no domestic company produces in this country*![3] To pour salt in the wound, Carpenter must purchase shells *now* for delivery after July 1, 1996.[4] Thus, the company is in the precarious position of making far-reaching financial commitments without knowing how the goods it buys will be treated at the time of entry. Such an unstable and unpredictable commercial environment—created by conflicting and confusing rules of origin, some of which are not yet even in final form—is simply unacceptable.

Carpenter suggests that this subcommittee's hearing on rules of origin is long overdue, and the company urges the members of the subcommittee, the entire Committee on Ways and Means, and the full House to work together with all affected industries in developing a sound, rational, commercially realistic regulatory regime for determining the origin of imported products. The current patchwork of inconsistent and often irrational rules is clearly harmful to American interests and American industry. It is undeniably harmful to Carpenter.

Carpenter was surprised and encouraged at Representative Crane's announcement that the subcommittee would produce a rule of origin bill by the end of the month. Representative Rangel, with tongue only partially in cheek, asked one of the witnesses whether the subcommittee should entertain the notion of repealing the marking law in its entirety. Carpenter supports just such a sweeping review of the marking law and a thorough examination of origin-determination in all its guises. The Uruguay Round Agreement specifically targeted the use of origin requirements as protectionist weapons

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[3]We applaud and second the very cogent question asked Mr. Moore of ATMI by Representative Ramstad: "If no United States company produces, or wishes to produce, downproof fabric, why is there a quota for it?" We note that, when pressed several times by Representative Ramstad for a responsive answer, Mr. Moore agreed that there should be no quota on downproof fabric if it was not domestically produced.

[4]The date that "Breaux/Cardin" regulations must go into effect by law.

detrimental to the free flow of trade. The Congress would do well to reexamine fully the rationale for origin determinations, and, in areas where such determinations are deemed necessary, to provide all-encompassing, well-researched, adequately debated, and industry-vetted legislation to replace the clanky, inconsistent, and—as Carpenter has demonstrated—inane and untenable conglomeration of origin requirements that assaults us all.

Carpenter Co. takes great pride in producing what we believe are the finest home textile products in the world. It is frustrating and tragically sad that such excellent products, made in plants in Texas, California, Pennsylvania, and Kentucky, and manufactured by American workers who also take great pride in their work and their industry, are subjected to a ludicrous regulatory scheme that robs them of their true identity. We ask this subcommittee for real change, and we applaud it for having taken the first step in righting an eminently correctable wrong.

Carpenter Co. expresses its appreciation to Representative Crane, Representative Rangel, and the entire Subcommittee on Trade for the opportunity to present its views for the record.

WRITTEN STATEMENT SUBMITTED ON BEHALF
OF THE COMPANY STORE ON RULES OF ORIGIN

This statement is being submitted on behalf of The Company Store, 455 Park Plaza Drive, La Crosse, Wisconsin 54603 a wholly owned subsidiary of Hanover Direct, Inc., 1500 Harbor Blvd., Weehawken, New Jersey 07087.

The Company Store is a leading manufacturer, wholesaler and retailer of down comforters, pillows and featherbeds in the United States. The Company Store markets the down comforters and pillows it domestically produces under The Company Store and Scandia Down brand names; it also wholesales to other retailers its domestically manufactured down comforters, pillows and featherbeds under the AmeriDown brand name. A recent catalogue from The Company Store is enclosed to illustrate the products it manufactures and sells. The Company Store, which began operations in 1911 as the LaCrosse Garment Company, currently employs approximately 800 people at our LaCrosse, Wisconsin facilities.

Unless the proposed application of two distinct country of origin provisions that are to be implemented by the U.S. Customs Service are expeditiously amended, The Company Store may be forced to cease manufacturing down comforters, pillows and featherbeds in the United States. The threatened manufacturing stoppage is not due to any extraneous trade barrier erected by some other nation or by marketplace competition. The stoppage would be attributable entirely to the U.S. Customs Service's construction and enforcement of the Section 334 of the Uruguay Round Agreements Act (Public Law 103-456, 108 Stat. 4809) and the interim NAFTA Customs Regulation section 102.19, the so-called "NAFTA preference override" provision.

To explain how these two country of origin provisions operate to undermine The Company Store's U.S. manufacturing capability, it is important to understand how the current country of origin framework employed by the U.S. Customs Service functions in a manner so as to permit The Company Store to competitively manufacture and sell down comforters and pillows in the United States. We shall then explain how the two proposals put forth by the U.S. Customs Service would destroy our U.S. manufacturing base. The final portion of this statement will contain our recommendations for relief from the potential manufacturing catastrophe we are facing.

Impact Of The Current U.S. Customs Service Country of Origin Rules On The Company Store

From a manufacturing perspective, in addition to down and feathers the other indispensable component needed to produce down comforters, pillows and featherbeds is the down proof cotton shell used to hold the down feathers in the comforter or pillow. Unlike other types of comforters and pillows, the shells used for down comforters and pillows must be of cotton and tightly woven so as to possess particular air permeability characteristics in its fabric. The air permeability cannot be too great because it would result in "down-migration," which refers to the phenomenon of down and feathers escaping through the fabric. On the other hand, if the air permeability is too restricted, the shells would trap too much air as the down and feathers are blown into the shells during the comforter and pillow production, resulting in the down comforter, pillow and featherbed resembling an inflated balloon.

The Company Store's down proof shell fabric specification is reflected in the 3.0mm nozzle standard set forth in American Society for Testing and Materials (ASTM) Designation D737-75. Concerted efforts over the last decade have been repeatedly undertaken by The Company Store to source, in the United States, down proof shell fabric which satisfies the ASTM Designation D737-

75 standard. Such domestic manufacturers as Spring Industries of Lyman, South Carolina, Miliken of Spartanburg, South Carolina, Burlington Industries of Greensboro, North Carolina and Dan River of Danville, Virginia have been contacted by The Company Store. Unfortunately, we must report that The Company Store has been unable to locate a single domestic supplier willing or able to supply The Company Store with the down proof cotton shell fabric we require. Equally unfruitful was The Company Store's separate efforts to source greige goods for down proof shell fabric in the United States. Faced without a domestic source for the down proof comforter, pillow and featherbed shells required to manufacture down comforters and pillows in the U.S., The Company Store was left with no alternative but to import down proof cotton shells for the comforters, pillows and featherbeds it produces domestically.

On a global basis China is the only viable source of down proof cotton fabric. Only limited amounts of down proof cotton fabric or down proof cotton shells for comforters, pillows and featherbeds have been available for direct import to the United States from China. The reason for this was, and continues to be, the difficulties associated with acquiring the appropriate quota category on Chinese down proof cotton fabric and/or shell exports to the United States.

The solution to the Chinese quota barrier was to have the cutting and assembly of the Chinese down proof fabric into a comforter or pillow shell take place in a country other than China. The Company Store has been having the cutting and assembly of its down proof comforter, pillow and featherbed shells largely take place in Hong Kong. Under the present country of origin rules utilized by the U.S. Customs Service, Hong Kong, not China, is considered the country of origin of the completed down proof comforter, pillow and featherbed shells because the Chinese fabric undergoes a "substantial transformation" in Hong Kong by virtue of the cutting and assembly operations that takes place in Hong Kong.

Since down proof cotton comforter and pillow shells from Hong Kong do not share the same quota difficulties as comparable Chinese products do, The Company Store uses Hong Kong produced down proof comforter and pillow shells for supplying its U.S. manufacturing operations. With this reliable and dependable source, The Company Store's U.S. manufactured down comforters and pillows have been able to compete with down comforters manufactured elsewhere in the world.

Impact of Section 334 of The Uruguay Round Agreements Act

With the passage of Section 334 of the Uruguay Round Agreements Act, The Company Store's competitive U.S. manufacturing capability has been seriously placed in jeopardy. The reason for this is because in proposed regulations implementing Section 334 that were published in the Federal Register of May 23, 1995 (60 Fed. Reg. 27378), the U.S. Customs Service would require that products classifiable under subheading 6307.90 of the Harmonized Tariff Schedule of the United States (HTSUS), which include The Company Store's imported down proof cotton comforter, pillow and featherbed shells, have their country of origin determined by a so-called "fabric forward" rule of origin.

The effect of the fabric forward rule of origin is to have the country of origin of the fabric used in the finished product determine the country of origin of the finished product, regardless of how extensive, costly or time consuming the processing may have been that transformed the fabric into the finished product. Hence the principles of "substantial transformation" or "country of assembly" become irrelevant for country of origin determination purposes; instead the country in which the fabric was made becomes the single determinative country of origin criteria. The result, for The Company Store, is that Hong Kong produced down proof cotton comforter pillow and featherbed shells become Chinese down proof

cotton comforter, pillow and featherbed shells because the fabric was made in China.

In practical terms, the down proof cotton comforter and pillow shells that The Company Store must acquire outside the United States in order to manufacture down comforters, pillows and featherbeds in the United States becomes virtually unobtainable. The reason for this is because the down proof cotton comforter shells will, under Section 334's fabric forward rule, be considered a product of China for quota purposes. From past importing experience The Company Store knows that it will not be able to receive from China the down proof cotton comforter, pillow and featherbed shells it requires to continue down comforter and pillow production in the United States.

The Section 334 fabric forward country of origin rule for down proof cotton comforter, pillow and featherbed shells is scheduled to go into effect on July 1, 1996, in accordance with Section 334(c).

Impact of NAFTA Preference Override

Making a bad situation even worse, is the current Customs Service interim NAFTA country of origin regulation 19 C.F.R. §102.19, which, if unchanged, will permit a loophole from the above-described fabric forward rule of Section 334, **BUT ONLY FOR CANADIAN AND MEXICAN MANUFACTURED DOWN COMFORTERS, PILLOWS AND FEATHERBEDS**. Unlike Canadian and Mexican produced down comforters, United States produced down comforters, pillows and featherbeds would remain subject to the harsh Section 334 fabric forward rule.

Under the section 102.19 NAFTA preference override provision currently in effect, a product that is entitled to receive favorable NAFTA tariff duty treatment will have its country of origin determined by "the last NAFTA country in which that good underwent production." Thus, a Canadian down comforter, pillow and featherbed manufacturer can freely import down proof shells from China into Canada (Canada has no quota restrictions on the Chinese shells) and manufacture down comforters, pillows and featherbeds in Canada. The manufacturing activities in Canada would entitle the completed down comforters, pillows and featherbeds to be imported into the U.S. under the favorable NAFTA tariff duty rate. But, more importantly, Canada would also be considered the country of origin of the comforters, pillows and featherbeds both for quota and marking purposes. Under the current NAFTA preference override provision, the down comforters, pillows and featherbeds imported from Canada into the U.S. would not be embraced by the Section 334 fabric forward rule. These down comforters, pillows and featherbeds would not be subject to Chinese quota, even though the fabric used in their production came from China. Additionally, the Canadian produced down comforters, pillows and featherbeds pursuant to the NAFTA preference override regulation, would be marked "Made In Canada."

Incredibly, if identical manufacturing operations took place in the U.S. - down proof shells imported from China were used in the U.S. production of down comforters, pillows and featherbeds - the resulting country of origin analysis would be entirely different. The imported down proof shells would be subject to Chinese quota under the fabric forward rule of Section 334. Furthermore, the finished down comforters, pillows and featherbeds would have to be marked "Made In China" because of the fabric forward rule.

The inequality of the country of origin treatment is patently clear. Despite undergoing the same manufacturing operations in Canada and the United States, the Canadian down comforters and pillows, by virtue of the NAFTA preference override provision of 19 C.F.R. §102.19, would not be subject to Chinese quota when imported into the U.S. and could be marked "Made in Canada." In contrast, the United States manufactured down comforters, pillows and featherbeds would have to be marked "Made In China" and the shells would be subject to Chinese quota.

Putting aside for the moment the quota issue, such country of origin labelling discrepancies are not only illogical, but they will plainly mislead the American public. Quite obviously United States manufacturing interests will also be placed at an enormous marketing disadvantage. Given an opportunity to purchase equally priced and comparable down comforters would the typical American consumer select the one marked "Made In Canada," or the one marked "Made In China"? It stands to reason that the consumer would likely select the former. Yet the truth of the matter would be that the down comforter labelled "Made In China" was actually manufactured in the United States. Astonishingly, Section 334 of the Uruguay Round Agreements Act and the interim Customs Service NAFTA preference override provision in 19 C.F.R. §102.19 would mandate that the identically produced articles in the United States and Canada be labelled "Made In China" and "Made In Canada", respectively.

In light of the above, we trust that members of the Subcommittee on Trade can better appreciate why our earlier reference to possibly ceasing down comforter, pillow and featherbed production in the United States would have to be seriously examined by The Company Store if modifications to Section 334 and the NAFTA preference override regulation are not adopted. Simply stated, by moving down comforter, pillow and featherbed production to Canada the quota difficulties with receiving supplies of Chinese down proof comforter, pillow, and featherbed fabric and/or shells could be removed, and the down comforters, pillows and featherbeds could be labelled "Made In Canada." In contrast, down comforter, pillow and featherbed manufacturing interests remaining in the United States would have severe quota problems in obtaining their needed down proof comforter, pillow and featherbed shells, as well as being compelled to label and market their U.S. manufactured products as having been "Made In China."

Relief Sought

To correct the inequities described above we urge that the following two steps must be taken:

1. Section 334 of the Uruguay Round Act must be amended in order that down proof comforter, pillow and featherbed shell imports are not subject to a fabric forward rule. Either down proof comforter, pillow and featherbed shells can be expressly excluded from the fabric forward rule set forth in Section 334 (b)(2)(A), or, alternatively, subheading 6307.90, HTSUS (which embraces down proof comforter, pillow and featherbed shells, as well as other articles), should simply be deleted from Section 334 (b)(2)(A). If either alternative is accomplished, down proof comforter, pillow and featherbed shells would be subject to the Section 334 (b)(1)(D) rule of origin, which provides that the country of origin is where the "textile or apparel product ... is wholly assembled."
2. The Customs Service must not be permitted to interpret NAFTA in such a manner so as to provide Canadian and Mexican textile and apparel manufacturing interests greater country of origin flexibility than U.S. interests. To that end the NAFTA preference override in 19 C.F.R. §102.19 should explicitly exclude from its embrace the textile and apparel products covered by the country of origin standards set forth in the post-NAFTA enacted Section 334 of the Uruguay Round Agreements Act.

It is important to bear in mind that the relief that we are requesting is not being sought to provide United States down

comforter and pillow manufacturers with an unfair advantage or upper hand in down comforter, pillow and featherbed production. Quite the contrary, what we are seeking is a correction to the imbalance of the playing field that has been created, not by other nations, but by a United States statute, Section 334 of the Uruguay Round Agreements Act, and U.S. Customs Interim Regulation 19 C.F.R. §102.19. Without the corrective action we seek, we seriously fear that the implementation of these two provisions will signal the death-knell of our ability to continue to compete as a down comforter pillow and featherbed manufacturer in the United States. The tragedy will be all the greater because the fatal wound will have been inflicted, not by some foreign government or by our competitors in the marketplace, but by our own government. We urge the Subcommittee on Trade to take expeditious and appropriate action to correct the problems we have outlined above before it is too late.

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The Company Store Book retained in Committee Files

Before the

TRADE SUBCOMMITTEE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

July 25, 1995

Statement of
Concorde Garment Manufacturing Co.

Concerning

Proposed Changes in Customs Rules of Origin For Apparel

We appreciate this opportunity to submit written comments on behalf of Concorde Garment Manufacturing Co. regarding Customs' proposed non-preferential rules of origin, particularly as they relate to imported apparel products.

Concorde Garment Manufacturing Co. ("Concorde") is one of the largest garment manufacturing companies located in Saipan in the Commonwealth of Northern Mariana Islands ("CNMI"). Concorde manufactures clothing for many reputable U.S. clothing retailers. Over the years, Concorde has invested a significant amount in the development of its industry in the CNMI and, in the process, has contributed substantially to the community in Saipan as well. Through its garment manufacturing company and other businesses, Concorde has contributed over $10 million in taxes a year to the CNMI.

Concorde applauds U.S. efforts to develop nonpreferential rules of origin which make origin determinations consistent, reliable, and transparent. However, care should be taken to ensure that these new rules do not adversely impact industries whose viability relies, in part, on manufacturing processes which were designed to conform to previous rules of origin. Currently, U.S. Customs is in the process of developing final rules applicable to country of origin determinations for textile and apparel products. In addition to developing its own rules of origin applicable to U.S. imports, the United States will also participate in World Trade Organization negotiations to develop harmonized nonpreferential rules of origin which would be applicable to all members of the WTO. Thus, exports of Concorde manufactured apparel products to the United States could be subject to two potentially disruptive changes in origin determination which would devastate the Commonwealth's garment industry.

Presently, rules of origin for textile and apparel products are contained in Section 12.130 of the Customs regulations (19 C.F.R. § 12.130). This section embodies the "substantial transformation" rule which essentially provides that the country of origin of a product is the country where that product underwent a change in name, use, or character, such that it became a new and different article of commerce. Under that section, cutting of fabric into parts constitutes a substantial transformation and hence, confers origin.

The U.S. Customs Service proposed new rules for determining origin for textile and apparel products in a Federal Register notice published on May 23, 1995. 60 Fed. Reg. 27,378. These new rules were required by Section 334 of the Uruguay Round Agreements Act. The proposed rules provide that such manufacturing processes as cutting, dyeing, and printing no

longer confer origin. Instead, the rules state that the place of assembly is the place of origin. This difference is crucial to garment manufacturers who have set up cutting operations in particular locales in order to benefit from unfilled quota levels or preferential duty treatment. This difference is also crucial to economies, such as the CNMI, who rely in large part on their garment industries for industrial development, export earnings, and employment.

Concorde established operations in the CNMI in order to take advantage of preferential duty treatment. Under the Covenant to Establish a commonwealth of the Northern Mariana Islands, the CNMI was accorded trading status equivalent to U.S. insular possessions. Therefore, imports to the United States from the CNMI are entitled to preferential duty status under General Headnote 3(a)(iv) of the Harmonized Tariff Schedule ("HTS"). Headnote 3(a)(iv) provides that articles which are the growth, product, or manufacture of an insular possession are entitled to duty-free treatment upon importation into the United States, provided that the article does not contain foreign materials comprising more than 70 percent of the total value of the article. With respect to textile and apparel products, the headnote specifies that the foreign material must not comprise more than 50 percent of the total value of the article. All other imports from the insular possessions receive column 1 most-favored-nation treatment. In sum, in order to receive duty-free treatment, imported textile articles must be the product of the CNMI and meet the 50 percent value-added requirement.

The Customs Service has issued several rulings regarding the circumstances under which textile articles imported from insular possessions are entitled to duty-free treatment. Most garment manufacturers in the CNMI import bolts of cloth material for processing into finished garments. Once imported, the bolts of material are marked and cut into component parts of various shapes and sizes. The pieces are then assembled together, undergoing numerous sewing operations, including hemming, serging, top stitching, and cover stitching. The garments then undergo inspection, trimming, pressing, folding, and packaging before being directly shipped to the United States. In referring to Customs regulations on origin for textile products, Customs has held that the operations of marking the imported fabric into pattern pieces, cutting the fabric into pieces of various sizes and shapes, and assembling the pieces together by means of numerous sewing operations, result in a substantial transformation of the foreign fabric. Accordingly, under current rules of origin, fabric that is imported into the CNMI which undergoes cutting and assembling is deemed to be a "product of" the CNMI. Although it is not entirely clear from the text, it would appear that these same processing and assembly operations would also confer CNMI origin under the Proposed Rules of Origin for textile products issued in connection with Section 334 of the Uruguay Round Agreements Act.

What is not clear from the Proposed Rules, however, is how the value of the foreign fabric would be treated for meeting the 50 percent value-added requirement; i.e. whether those same processing operations would assign the value of the fabric to the cost of "foreign materials," or to the cost of the materials produced in the CNMI. In a final interpretive rule, Customs has previously determined that the "double substantial transformation concept" is applicable in determining whether products meet the value requirement established under General Headnote 3(a). T.D. 88-17, 22 Cust. B. & Dec. 128 (1988). In explaining their determination, Customs stated:

> Allowing the double substantial transformation concept to be applied means that the value of foreign material . . .may be considered as the value of material produced in the insular possession for the purpose of the 70 or 50 percent value determination if the foreign material is transformed in the insular possession through a substantial processing operation into a new and different product with a different name, character or use, and the new and different product is then transformed into yet another new and different product which is exported to the U.S.

In a subsequent ruling, Customs determined that the same processing operations, mentioned above, fulfilled the double substantial transformation requirement. First, Customs noted that it has consistently held that the cutting of fabric into specific or defined shapes for further assembly

is sufficient to substantially transform the fabric into a new and different article of commerce. Thus, the first substantial transformation occurs when the fabric is cut into defined shapes and sizes. Customs went on to hold that the second substantial transformation occurs when the garment is assembled, inspected, trimmed, ironed, and packaged for shipment to the U.S. Customs noted that the overall processing operations were substantial, and therefore constituted a second substantial transformation.

As stated previously, it is not clear whether this double substantial transformation requirement would be met under the Proposed Rules issued by Customs. Arguably, the Proposed Rules only cover country of origin determinations, not foreign value determinations. However, under current rules, country of origin determinations and foreign value determinations are made on the basis of the same standard -- the substantial transformation test. The Proposed Rules do not state whether the new rules of origin would also be applicable to foreign value determinations.

This distinction is critical to Concorde. Because Concorde uses high quality foreign fabric in its manufacturing, Concorde's ability to meet the 50 percent value added requirement would be circumscribed if "cutting" operations were eliminated as the first transformation in the double substantial transformation test.

This deficiency should be corrected in the Final Rules. Despite a statutory mandate to issue Final Rules by July 1, 1995, Customs has failed to do so, even though the new rules are to take effect on July 1, 1996, less than one year away. In the meantime, garment manufacturers in the CNMI are faced with additional uncertainty regarding the World Trade Organization rule-of-origin harmonization process and how that will affect operations in the CNMI.

From a business planning standpoint, Concorde and other garment manufacturers in the CNMI are crippled with uncertainty. Many retailers will shortly place orders for final delivery of merchandise after July 1, 1996. However, these retailers will not know what the final rules of origin will be for their textile products, nor will they know what the duty treatment will be.

Ultimately, in order to avoid this uncertainty, and, in order to avoid lost sales from apparel no longer affordable to consumers, garment manufacturers may be forced to set up operations elsewhere. Such a result would be tragic and self-defeating both for CNMI development and for U.S. foreign policy. The exit of the garment industry from the CNMI will reduce government revenues by approximately $30 million, adversely affecting business activities such as airlines, shipping, insurance, retailers, wholesalers, apartment owners, telephone companies, banks, and automobile dealers. Many of the smaller enterprises on the islands which rely on servicing the garment industry and its employees will be forced to close since the garment industry is one of the largest supporters of small businesses on the islands. Revenue generated by the garment industry through the Commonwealth Utility Corporation and the Commonwealth Health Center will be completely gone. Likewise, the U.S. government will almost certainly be pressed to subsidize the revenue shortfall. Of course, job losses of this magnitude cannot possibly be replaced, and welfare programs will have to be expanded.

Such an outcome is certainly not in keeping with the World Trade Organization Agreement on Rules of Origin which seeks to avoid rules of origin which are restrictive, distorting, or have disruptive effects on international trade.

Concorde believes that Customs should modify the Proposed Rule so as to continue to permit the treatment of cutting as a substantial transformation for purposes of calculating the value qualification under Headnote 3(a). In addition, Congress should authorize Customs' deferral of the promulgation of new rules of origin for textile and apparel products until the World Trade Organization completes its work on the harmonization of global rules of origin. This deferral would enable foreign manufacturers additional time to adjust to the changes brought about by global rules of origin and allow the U.S. government additional time to consider the potential impact of changes in the way the country of origin is determined for textile and apparel products.

STATEMENT OF
FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA

HEARING ON RULES OF ORIGIN

HOUSE WAYS & MEANS COMMITTEE
SUBCOMMITTEE ON TRADE

This statement is submitted by the Footwear Distributors and Retailers of America, 1319 F Street, N.W., Washington, D.C. 20004 ("FDRA") in connection with the hearing on rules of origin. We understand that the Subcommittee seeks testimony on the administration of United States law for preferential and non-preferential rules of origin and the prospects of the World Trade Organization ("WTO") work program on rules of origin.

FDRA is a voluntary association of some 70 retailers, distributors, importers and manufacturers who account for approximately three quarters of footwear sales in the United States. Many FDRA members market footwear on an international scale. As such, they have a keen interest in harmonized rules of origin.

Generally, FDRA supports the goals of the WTO work program and, in particular, would support rules of origin based upon changes in tariff classification.

FDRA is generally satisfied with the current administration of United States non-preferential rules of origin as they relate to footwear. FDRA opposes the preferential rules of origin applied to footwear. The preferential rule of origin found in the North American Free Trade Agreement ("NAFTA") is unfair to United States producers. The NAFTA preferential rule of origin does not allow the use of uppers made in a fourth country. Thus, footwear made in the United States from an upper produced in the Caribbean cannot qualify as an "originating goods" eligible for the NAFTA tariff preference. This rule discriminates against those United States producers who, in an effort to compete in international markets, import uppers.

As noted above, FDRA supports current United States non-preferential rules of origin for footwear. Proposed Section 102.20(k) of the Customs Regulations provides that the rule of origin for footwear (all footwear is classified in Chapter 64 of the Harmonized Tariff Schedule of the United States ["HTS"]) is that a change in classification into HTS headings 6401 through 6405 from any other chapter or heading outside that group, except tariff items 6406.10.05 through 6406.10.50, constitutes a substantial transformation. HTS subheadings 6406.10.05 through 6406.10.50 provide for "formed" uppers. "Formed" uppers are defined in Additional U.S. Note 4, Chapter 64, HTS, as uppers which are closed at the bottom and which are shaped by lasting, molding or by other means, but not by simply closing at the bottom. Thus, a change in classification from uppers, not formed, to complete footwear constitutes a substantial transformation.

This rule reflects current United States practice. The general rule followed by the United States Customs Service is that the conversion of uppers, not formed, into complete footwear represents a substantial transformation and a change in the country of origin. On the other hand, a change in classification from "formed" uppers to complete footwear is not considered a substantial transformation.

While this rule of origin is not exempt from criticism, it is far better than rules which are applied by some foreign countries. For example, the general rule of origin for footwear in Mexico is that the country of origin is the place where the upper is manufactured. In other countries, final assembly confers origin.

Many FDRA members manufacture footwear in this country using imported uppers. This footwear is exported to Canada, the European Union and Japan. At present, whether or not the imported uppers are classified as "formed", their conversion into complete footwear in this country creates a product of this United States origin for most export purposes. Mexico is a singular exception. Adoption of a rule of origin at the international level which is not more restrictive than present United States practice is urged. A rule which is more restrictive in the sense that it would preclude a substantial transformation when footwear is manufactured using imported uppers which are not "formed", would have an adverse impact on the ability of many United States producers to maintain and expand export markets. This is because footwear manufactured in the United States would no longer be considered to have United States origin but would be deemed to originate in the country where the imported upper was manufactured.

To summarize, the members of FDRA support present United States practice with respect to the non-preferential rule of origin applicable to footwear. In the course of negotiations leading to international harmonization of customs rules of origin, the United States should not propose, or accept, a more restrictive rule of origin for footwear. FDRA does not support the preferential rule of origin as found in NAFTA.

HOFFMAN
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July 21 1995

Phillip D. Moseley
Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: 19 CFR Part 10 et al
Rules of Origin for Textile and Apparel Products: Proposed Rule
Hearing Date July 11, 1995

Dear Sir,

Hoffman California Fabrics is strongly opposed to 19 CFR Part 10 et al, Rules of Origin for Textile and Apparel Products: Proposed Rule. These changes will destroy the oldest indigenous industries related to textiles in this Country: Quilting and Crafts.

There has been a resurgence of quilting and related crafts not only in the United States, but it is a worldwide phenomenon. These activities not only require skill, patience and creativity, but the fabrics used must be cottons of the highest quality. These industries primarily use sheeting (60 x 60) or shirting (68 x 68) both are 100% cotton and neither quality is being manufactured in the U.S. in any quantity. Profit margin is too small. These preferred textile qualities are woven in other countries, i.e. China, Pakistan, Korea, etc.

Hoffman has these cotton qualities printed and finished overseas which more than triples the cost of the original unfinished goods.

There is no alternative to printing these fine cottons overseas. The U.S. has only one wet-print plant which does not have sufficient capacity to supply the U.S. needs.

These proposed changes in the Rules of Origin in light of facts stated above are not only unworkable but grossly unfair to the entire Home Sewing, Quilt and Craft Industries.

It is our contention that the Rules of Origin should remain unchanged.

Respectfully,

Philip Hoffman
Chairman of the Board
Hoffman California/international Fabrics
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STATEMENT OF THOMAS W. TUSHER
PRESIDENT AND CHIEF OPERATING OFFICER
LEVI STRAUSS & CO.

Levi Strauss & Co. appreciates the opportunity to express its views on customs rules of origin applied to trade in textile and apparel products, and on the approach of the United States Government to the World Trade Organization's rules of origin harmonization effort.

Levi Strauss & Co. is the world's largest manufacturer of branded apparel. Based in San Francisco, California, our Company produces jeans, jeans-related products, and sportswear under the Levi's®, Dockers®, and Britannia® brands in the United States and more than 60 countries. While Levi Strauss & Co. is a global company, it remains firmly committed to its U.S. manufacturing roots. We employ approximately 25,000 American workers in 41 facilities in 20 states.

As the Committee is aware, the U.S. Customs Service is in the process of finalizing new rules of origin for textile and apparel products. The rule change, which was mandated by last year's implementing legislation for the Uruguay Round Agreement, would change the basis for determining the country of origin of textile and apparel products from the country in which fabric is cut to the country in which a garment is assembled.

Our Company regards the proposed new rule of origin for textile and apparel products as unnecessary and poorly timed. The rule change for apparel will alter the application of U.S. import quotas and will require significant and costly adjustments to Levi Strauss & Co.'s foreign sourcing practices. Our Company is particularly concerned about the prospect of facing two disruptive changes to origin rules within a period of five years or less: first, when the legislated rule change takes effect in July 1996; and second, at the conclusion of the World Trade Organization's (WTO) program to harmonize global rules of origin, as required by the Uruguay Round Agreement on Rules of Origin.

We also believe that this rule change violates the GATT Agreement on Rules of Origin, which requires GATT members to ensure that changes undertaken prior to the completion of the WTO harmonization program do not "create restrictive, distorting, or disruptive effects in international trade."

With the new U.S. rules scheduled to be implemented on July 1, 1996, and the WTO work program about to begin, major changes in origin standards will create uncertainty and disruption to our business. Such uncertainty and disruption could:

- Frustrate efforts to rationalize our supply chain and to remain globally competitive because extensive, costly, and hurried adjustments would be required in our overseas sourcing operations;

- Undermine our ability to meet customers' demands and provide consumers with affordable, high-quality merchandise;

- Limit textile and apparel supplies and make products more costly because worldwide trade in our industry is controlled by quotas; the rule change will restrict a significant portion of this trade, making supplies more expensive; and

- Undermine contractual relationships that our Company has carefully developed over time to ensure that our suppliers adhere to strict standards on employment and environmental practices.

In light of these factors, Levi Strauss & Co. believes that the United States should defer implementation of the new rules of origin on textile and apparel pending the completion of the World Trade Organization harmonization work program, and we encourage the Committee to consider legislation to bring this about. Implementing new rules now – at the beginning of the WTO work program – is preemptive, unnecessary, and will disadvantage the competitiveness of American companies and have an adverse effect on American consumers.

Levi Strauss & Co. supports the goal of globally harmonized rules of origin and we encourage the U.S. Government to be an active and constructive participant in the WTO work program on this issue. We hope that U.S. negotiators involved in the work program will encourage the development of rules of origin for our products which are fair and transparent. Any rules developed through the harmonization program should also reflect the Uruguay Round's emphasis on liberalization of trade in textile and apparel products -- a standard which, in our view, is not met by the textile and apparel rules of origin currently being developed by Customs.

Levi Strauss & Co. looks forward to working with this Committee and with the Administration on developing a constructive approach to the WTO work program on rules of origin.

WHITE & CASE

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July 24, 1995

VIA HAND DELIVERY

The Honorable Philip M. Crane
Chairman
Subcommittee on Trade
Room 1104
Longworth House Office Building
Washington, D.C. 20515

Re: Rule of Origin

Dear Mr. Chairman:

These comments are submitted on behalf of McCormick & Company, Incorporated (hereinafter "McCormick") in the context of your hearing on proposed changes to the rule of origin. McCormick is a U.S. manufacturer of spice products, the overwhelming majority of which are manufactured from plants and plant parts which are not grown in the United States.

McCormick has been importing the raw materials for spice products and manufacturing and packaging the finished products in the U.S. for over 100 years. During that entire time, the manufacture of spice products from raw materials has always been regarded as a "substantial transformation" for purposes of determining country of origin. The Department of the Treasury issued proposed regulations on rule of origin in January of 1994 which would have affirmed this longstanding practice. Recently, however, Treasury changed their original proposal for these regulations such that the manufacture of spices from raw materials would not constitute a substantial transformation.

In addition, the Customs Service has issued a proposed ruling which also would reverse this longstanding practice and which would impose new country

The Honorable Philip M. Crane

of origin marking requirements on U.S. spice manufacturers in just two (2) months. This proposed ruling puts McCormick in an especially hazardous position as it could require virtually immediate changes to the packaging for thousands of different spice products.

This abrupt change in the treatment of spices manufactured from imported plants and plant parts is unwarranted and imposes a tremendous potential burden on McCormick and the rest of the U.S. spice industry. Moreover, the U.S. Customs Service recognizes this and, due to the unusual nature of the spice industry, the U.S. Customs Service has said that it would support legislation specifically exempting the spice industry from country-of-origin marketing requirements.

The attached submission explains in greater detail the background and reasons for McCormick's request for legislative relief from the proposed changes to the rule of origin.

If you require any further information or material, please contact the undersigned.

Respectfully submitted,

Alan M. Dunn
Vincent Bowen

STATEMENT OF ALAN M. DUNN AND VINCENT BOWEN
WHITE & CASE
ON BEHALF OF MCCORMICK & CO., INC.

I. INTRODUCTION

These comments are submitted on behalf of McCormick & Company, Incorporated ("McCormick")[1/] in connection with the subcommittee's consideration of Customs rules of origin for imported goods.

McCormick is a diversified specialty foods company and a leader in the manufacturing, marketing, and distribution of spices, seasonings, flavorings and other food products to the food industry, including retail outlets, food service and food processors. McCormick employs over 6,300 people in the United States. McCormick imports raw plant parts from over 80 different countries and manufactures them in its U.S. facilities into thousands of different types of finished single spice products and spice blends. On an annual basis, McCormick produces hundreds of millions of units of finished single spice products from imported raw plant parts and distributes them to retail outlets, food service establishments, and food processing industries.

II. SUMMARY

The U.S. Customs Service ("Customs") has never required country-of-origin markings on finished spice products made by the U.S. spice manufacturing industry. Recently, however, Customs has undertaken an initiative that would summarily reverse its long-established practice and the traditional rules and criteria used to assign origin. If finalized in their current form, the new rules proposed by Customs would require McCormick, for the first time in its 106-year history, to label finished spice products manufactured in the United States with the names of the countries where the raw plant parts used to make the spices were grown. The rule change contemplated by Customs would require McCormick to relabel literally thousands upon thousands of different finished spice products, encompassing hundreds of millions of units per year, at an exorbitant cost.

If Customs finalizes its proposed spice rule in its current form, McCormick will soon be required to indicate on its spice product packages and containers the origin of the raw plant parts used in making them. Such disclosure requirements would impose enormous costs and administrative burdens on the company. Customs' proposal would affect over 5,500 different single spice products produced by McCormick. McCormick would be required, in short order, to design new labels for literally thousands and thousands of different products and packages at all market levels, affecting hundreds of millions of units. In addition to the cost of disposing of current label inventories and creating new ones, McCormick would have to establish, at substantial cost, a new system to trace imports of hundreds of materials sourced from over 80 different countries through its inventory system. It is likely that no one company has ever confronted such an enormous burden in complying with country-of-origin labelling laws.

It is ironic that these burdens and costs are being thrust upon McCormick in the context of U.S. marking laws, which are designed to protect U.S. industries and U.S. consumers. The imposition of marking requirements on spice products would not be consistent with the basic purposes of the marking statute, which is designed to give U.S.

1/ 18 Loveton Circle, P.O. Box 6000, Sparks, Maryland 21152-6000.

industries a competitive advantage over foreign suppliers and to provide consumers a choice between domestic and foreign goods. These purposes would not be served by requiring origin markings on spice products. The vast majority of spice materials consist of tropical plant parts that cannot be cultivated in the United States. Rather than benefitting any U.S. interests, Customs' proposal would impose enormous financial and administrative burdens on the U.S. spice manufacturing industry, which would be forced to pass on the new costs to U.S. consumers.

For these reasons, the U.S. spice industry must have relief from the proposed changes in rule-of-origin marking requirements. McCormick strongly believes that Customs should maintain the position it has taken since the inception of marking requirments that U.S. spice operations effect a substantial transformation. The Customs Service has indicated that it would support a statutory provision exempting spices from country-of-origin marking requirements. McCormick believes that a statutory exemption is necessary to avoid the tremendous cost burden which the proposed Customs' changes would impose.

III. BACKGROUND OF COUNTRY-OF-ORIGIN MARKING REQUIREMENTS AS APPLIED TO SPICE PRODUCTS AND STATUS OF CUSTOMS PROCEEDINGS TO REVERSE SPICE ORIGIN RULES

Under the U.S. country-of-origin marking statute (19 U.S.C. § 1304), every article of "foreign origin" (or its container) imported into the United States must be marked with the country of origin of the article. Country of origin markings are required until the article reaches the "ultimate purchaser." U.S. processors who subject imported materials to a process of manufacture that "substantially transforms" them into U.S. products are treated as ultimate purchasers of the imported items, and are not required to mark such products.

In its 106-year history, McCormick has never been required to place country-of-origin markings on finished spice products that the company manufactures from imported raw plant parts. U.S. Customs Service import specialists have taken the position that the U.S. spice manufacturing industry is the ultimate purchaser of imported raw plant parts used to make spices. Customs has consistently determined that spice manufacturing operations, including sterilizing, cleaning, separating, reconditioning, milling and grinding, "substantially transform" imported plant parts, which thus lose their status as articles of "foreign origin."

Moreover, on January 3, 1994, Customs initiated rulemaking proceedings to establish product-specific origin rules to implement the requirements of NAFTA Annex 311,[2] which would have again confirmed that crushing, grinding or powdering spice materials effects a substantial transformation. On the same day, Customs proposed to use the product-specific origin rules developed pursuant to Annex 311 in all Customs programs requiring an origin determination, including country-of-origin marking laws.[3]

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[2] See Rules for Determining the Country of Origin of a Good for Purposes of Annex 311 of the North American Free Trade Agreement, 59 Fed. Reg. 110, 116 (Jan. 3, 116).

[3] See Rules of Origin Applicable to Imported Merchandise, 59 Fed. Reg. 141 (Jan. 3, 1994).

The original Annex 311 rules proposed by Treasury treated crushing, grinding or powdering of single spices (0904-0910), accompanied by retail packaging, as a substantial transformation.[4/] Such proposal fulfilled Customs' intent to "codify" existing practice with respect to retail spice products and thus did not elicit any objections from any U.S. interests.[5/]

However, in March 1995, during the pendency of the rulemaking proceedings, Customs Headquarters issued a proposed ruling holding that sterilizing and grinding of imported single spice materials did not effect a substantial transformation, and that finished spice products resulting from such operations were required to be marked with the "foreign" origin of the materials.[6/] According to the proposed ruling, the involved importer provided only a "brief explanation" of the U.S. processing, consisting of a two-sentence statement identifying some of the processes involved, but without describing any of the operations. Unfortunately, Customs did not solicit any more information from the affected importer, and, based on the extremely limited information that was provided, concluded that spice sterilization and grinding did not effect a substantial transformation.

Recognizing that such position represented a change of practice, Customs invoked the procedures of 19 U.S.C. § 1625, published Ruling 735599 in proposed form in the Customs Bulletin and invited interested party comments on the correctness of its new interpretation.[7/] On June 30, 1995, in response to Customs' solicitation of comments, McCormick provided the Customs Service with a detailed description of the operations of the U.S. spice manufacturing industry (including sterilizing, cleaning, reconditioning, separating, milling, grinding and packaging) and the effect of these operations on imported plant parts.[8/] As discussed therein, these processes alter the fundamental character and chemical composition of the raw materials and add substantial cost and value, thereby substantially transforming raw plant parts into finished spice products.

Customs proposed to apply the proposed ruling across the board to all spice imports, despite the fact that the very same issue -- origin rules for spices -- was being addressed as part of proposed regulations in concurrent rulemaking proceedings, which had proposed a rule that was totally opposite of the proposed ruling. To compound the confusion, the Section 1625 procedures invoked by Customs with respect to proposed Ruling 735599 required an expedited "final" decision on the origin issue by July 23,

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4/ See 59 Fed. Reg. at 116.

5/ The only comments received on the spice proposal were submitted by Revenue Canada, which approved the U.S. proposal.

6/ See proposed Customs Ruling 735599 (March 2, 1995). In the same proposed ruling, Customs held that the blending of different ingredients into spice blends (e.g., curry powder, celery salt and pickle spice) was a substantial transformation.

7/ See 29 Customs Bulletin and Decisions, No. 21 pp. 3-10 (May 24, 1995).

8/ McCormick's June 30 comments to Customs are provided in Attachment 1.

1995. Due to this time constraint, Customs Headquarters Marking Branch had a maximum of six business days to analyze the detailed information and arguments submitted by McCormick, before finalizing their decision and submitting their written opinion for review and signature by the director of the Commercial Ruling Division. The two separate administrative proceedings (proposed ruling and proposed regulations) threatened McCormick with the back-to-back imposition of inconsistent origin rules that would change (and then immediately rechange) marking requirements on several thousand products produced by the company.

Accordingly, on July 12, 1995, McCormick formally requested the Customs Service to withdraw the Section 1625 proceedings, and to consider the origin issue solely in the context of its separate regulatory rulemaking proceedings, as originally intended.[9/] McCormick urged Customs to withdraw the proceedings on two grounds. First, withdrawal was necessary to avoid the consectutive imposition of two sets of origin rules with potentially inconsistent definitions of substantial transformation. Second, withdrawal was requested to afford the responsible Customs officials with sufficient time to consider all the information and precedent required to make an informed decision.[10/]

In May 1995, after proposed Ruling 735599 was issued, Customs summarily reversed its position on spice origin rules in the proposed regulatory rulemaking proceedings.[11/] Customs reversed its position without benefit of any input from interested parties. The reversal was based solely on the conclusions of unfinalized Ruling 735599, which itself 1) was based on little or no information on the nature or effect of spice manufacturing operations, and 2) failed to consider prior rulings applying the substantial transformation concept to other food products subject to analogous processes. Notwithstanding these problems, Customs moved toward promulgating the proposed ruling as a formal regulation.

On July 19, 1995, McCormick submitted comments to Customs objecting to Customs proposed reversal of position in the regulatory rulemaking proceedings.[12/] The company's July 19 comments reiterate the concerns raised by the company in its prior comments in the proposed ruling procedures. McCormick again attempted to draw Customs' attention to the fact that the new position on spice origin rules was inconsistent with past practice and that it was based on a ruling that itself was based on inadequate information and that did not address the relevant precedent. The company's comments also requested Customs

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[9/] McCormick's letter requesting withdrawal of the Section 1625 proceedings is provided in Attachment 2.

[10/] In the letter, McCormick reiterated its prior invitation for Customs officials to tour the company's spice mill plant in nearby Hunt Valley, Maryland to witness first-hand the spice manufacturing operations to be affected by their ruling. As of to date, Customs officials have not responded to the invitation.

[11/] See Rules for Determining the Country of Origin of A Good for Purposes of Annex 311 of the North American Free Trade Agreement; Rules of Origin Applicable to Imported Merchandise, 60 Fed. Reg. 22312, 22319 (May 5, 1995).

[12/] McCormick's July 19, 1995 comments are provided in Attachment 3.

to delay the effective date of any rule change, in order to afford McCormick sufficient time to comply with new marking requirements on several thousand spice products that would be affected by an adverse origin ruling.

IV. THE OPERATIONS OF THE U.S. SPICE MANUFACTURING INDUSTRY SUBSTANTIALLY TRANSFORM IMPORTED RAW PLANT PARTS INTO FINISHED SPICE PRODUCTS.

The processing operations of U.S. spice manufacturing industry, including sterilizing, cleaning, separating, reconditioning, milling and grinding are described in detail in McCormick's June 30, 1995 comments submitted in connection with the Section 1625 proceeding. As indicated therein, all of the standard criteria and factors considered in applying the substantial transformation test provide overwhelming support that U.S. spice manufacturing operations effect a substantial transformation.

- U.S. spice manufacturing operations are intensive, expensive, time-consuming, technologically sophisticated processes that transform raw plant parts of various compositions, sizes, shapes, textures and other characteristics into useable ground spices with a uniform dispersion of aromatic and flavoring compounds.

- The conversion of raw plant substances into finished spice products changes the fundamental and essential character of the materials. During the U.S. grinding process, the cellular walls containing the essential or volatile oils rupture and shatter, releasing the aromatic and flavoring compounds that are the essence of spices, and dispersing them uniformly throughout the ground particles. It is during the U.S. grinding process that the material assumes the character (taste and smell) of a spice.

- The U.S. sterilization process results in changes to the chemical composition of the spices, including deactivation of naturally occurring lipase enzymes that accelerate spoilage of food products that are seasoned with spices.

- The U.S. operations add significant cost and value to the spice materials. In fact, as pointed out in McCormick's June 30 submission, Customs has never issued a negative substantial transformation ruling in any case where value added was as high as the value added in McCormick's spice operations. Customs' failure to consider the value-added criterion conflicts with well-established administrative practice and judicial precedent.

- The U.S. operations are substantially more involved and complex than the operations in the countries of growth. Imported spices are imported in raw, unrefined form, and are typically dried by crude sun-drying methods. Customs' failure to consider the relative intensity and complexity of the foreign and U.S. operations conflicts with court cases requiring such a comparison.

- Customs' revised position on spices is inconsistent with rulings applying the

substantial transformation concept to other agricultural and food products. Customs has ruled that substantial transformations occur from processes that volatilize the essential oils and flavoring ingredients in other raw fruit/vegetable substances in converting them into processed fruit/vegetable food articles.[13/] Customs has also found substantial transformations in other food rulings involving less extensive processing and less significant changes to the material.[14/]

- Customs' proposed origin rules on spices contain a fundamental inconsistency that would lead to absurd results. Under the agency's proposal, simply placing a pepper berry in the sun to dry is a substantial transformation, due to a tariff shift from Chapter 7 to Chapter 9. However, under the same proposal, taking the dried peppercorn and subjecting it to sterilizing treatments, cleaning, separating, reconditioning, milling and grinding is not a substantial transformation.

- Customs' proposed origin rule for single spices is substantially more strict than the proposed origin rules for other agricultural products undergoing identical processes. For example, the rules provide that various forms of milling (including hulling, rolling, flaking, slicing or grinding) of grains (wheat, barley, rye, etc.) result in substantial transformations by themselves.[15/] However, the proposed rules for spices unaccountably provide that grinding raw plant parts used in spices is not a substantial transformation, with or without accompanying operations. The arbitrariness of the spice rule is compounded by the fact that the grain and spice industries use the exact same types of grinding equipment. Requirements of uniformity, consistency and basic principles of fairness compel reinstatement of the long-established spice rule.

For these reasons and more, the long-established spice rule of origin should remain unchanged. McCormick strongly believes that there should be no change to the past 50 years of practice treating spice manufacturing operations as a substantial transformation for marking purposes. In the alternative, the U.S. spice industry must have relief from the proposed changes in rule of origin as they affect marking requirements. The U.S. Customs Service has indicated that it would support a statutory exemption for spices under the marking law. McCormick believes that a statutory exemption is necessary to avoid the tremendous cost burden which the proposed Customs' changes would impose.

13/ See Customs Rulings 554486 (March 26, 1987) and 555982 (Aug. 2, 1991).

14/ See Customs Ruling 773162 (Nov. 5, 1990) (finding crab shelling operations to be a substantial transformation).

15/ See 59 Fed. Reg. at 116 (conversion of unmilled grains of Chapter 10 into milled grains of Chapter 11 satisfies tariff-shift rules).

V. THE IMPOSITION OF MARKING REQUIREMENTS ON FINISHED SPICE PRODUCTS WOULD IMPOSE ONEROUS COSTS AND BURDENS OF THE U.S. SPICE MANUFACTURING INDUSTRY AND WOULD BE INCONSISTENT WITH THE PURPOSES OF THE MARKING LAW.

A fundamental purpose of the U.S. country-of-origin marking law is to provide an advantage for U.S. industries over foreign products in the marketplace. In reviewing the origins of marking requirements, a U.S. Court of Appeals recognized that --

> The purpose was to apprise the public of the foreign origin and thus to confer an advantage on domestic producers of competing goods. Congress was aware that many consumers prefer merchandise produced in this country.[16/]

In requiring foreign goods to be marked, "Congress, of course, had in mind a consumer preference for American made goods."[17/]

Most spice materials, including those that account for an overwhelming portion of U.S. imports, are indigenous to and cultivated in certain tropical and subtropical climates that do not exist in the United States. By importing all of these spices in their raw form (i.e., as parts of plants and trees), McCormick has arranged its operations to ensure the maximum amount of U.S. manufacturing activity that is possible. No U.S. industry could possibly gain any competitive advantage if Customs began requiring disclosure of the origin of raw plant and tree parts and fruits that are not produced in the United States.[18/] Further, informing the consumers of the specific foreign origin of the raw materials will not facilitate their purchasing decisions on finished spices made from raw parts of plants not grown in the United States.

If Customs finalizes its proposed spice rule in its current form, McCormick will soon be required, for the first time in its 106-year history, to indicate on its spice product packages and containers the origin of the raw plant parts used in making them. Such disclosure requirements would impose enormous costs and administrative burdens on the company. Customs' proposal would affect over 5,500 different single spice products produced by McCormick. McCormick would be required to design new

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16/ United States v. Ury, 106 F.2d 28, 29 (2d Cir. 1939).

17/ National Juice Products Ass'n v. United States, 628 F. Supp. 978, 989, n.14 (Ct, Intl Trade 1986). The court also stated that "{t}he policy underlying the country-of-origin marking statute ... is to facilitate consumer purchasing decisions and to protect American industry." Id. at 989, n.15.

18/ Significantly, no U.S. industries objected when Customs announced in early 1994 that milling and retail packaging of raw spices was a substantial transformation for marking purposes. See 59 Fed. Reg 110, 141 (Jan. 3, 1994). The absence of any industry objections indicates that there is no competitive advantage to be gained by any U.S. industry by requiring containers and packages of ground spices to indicate the foreign countries where the plants are grown.

labels for literally thousands and thousands of different products and packages at all market levels, affecting hundreds of millions of units.

In addition to the cost of disposing of current label inventories and designing new ones, McCormick would have to establish, at substantial cost, a new system to trace imports of hundreds of materials sourced from over 80 different countries through its inventory and production system. In addition, there is substantial confusion regarding the exact method and manner of origin marking to be required by Customs for products made from materials that are sourced from several countries and commingled in inventory and production. It is likely that no one company has ever confronted such an enormous burden in complying with country-of-origin labelling laws.

It is ironic that these burdens and costs are being thrust upon McCormick in the context of U.S. marking laws, which are designed to protect U.S. industries and U.S. consumers. The purposes of the marking statute -- i.e., to provide domestic industries a competitive advantage and to allow consumers to knowingly choose between domestic and foreign products -- would not be served by requiring origin markings on spice products. The vast majority of spice materials consist of tropical plant parts that cannot be cultivated in the United States. Rather than benefitting any U.S. interests, Customs' proposal would impose enormous financial and administrative burdens on the U.S. spice manufacturing industry, which would be forced to pass on the new costs to U.S. consumers.

Thank you for your consideration of these comments.

Respectfully submitted,

Vincent Bowen

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Attached materials retained in Commitee Files

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July 25, 1995

Phillip D. Mosley
Chief of Staff, Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Comments on Rules of Origin
Written Statement of Micron Technology

Dear Mr. Mosley:

These comments are submitted on behalf of Micron Technology, Inc. ("Micron"), a United States-based producer of semiconductors, in particular, Dynamic Random Access Memory ("DRAM") and Static Random Access Memory ("SRAM"), which are used in all personal computers and numerous other electronic products. Micron currently has a major semiconductor fabrication and assembly facility in Boise, Idaho, and has begun construction of a major greenfield semiconductor fabrication and assembly facility in Lehi, Utah. Micron appreciates the opportunity to submit its views to the Committee regarding international rules of origin, and in particular about the interplay between establishing predictable rules of origin and the ability of the Department of Commerce to establish effective antidumping and countervailing duty orders.

Micron has suffered in the past from predatory dumping by Japanese and Korean DRAM producers, and has benefited from the vigorous enforcement of the U.S.

antidumping laws, most recently in the investigation of *DRAMs From the Republic of Korea* (AD order 58 Fed. Reg. 27520 (May 10, 1993)). That ruling depended upon the Commerce Department being able to shape the scope of the order to fit the specialized circumstances of the worldwide DRAM industry. The Commerce Department specifically stated: "Processed wafers produced in Korea but packaged, or assembled into memory modules, in a third country are included in the scope." 58 Fed. Reg. at 27520. This definition of the scope of the order was necessary to prevent the easy circumvention of the antidumping finding through the expedient of having the less costly and complicated packaging operation simply carried out in a third country. Without this flexibility, circumvention of this antidumping order would have been far easier than it is.

Micron is therefore concerned that as international harmonization discussions continue under the auspices of the World Trade Organization, that the United States continue to ensure that the harmonization of the rules of origin does not hamper the ability of the administering authority to tailor the scope of antidumping and countervailing duty orders to meet the requirements of the effective implementation and enforcement of U.S. unfair trade laws. A rule of origin should not override or dictate a result different than contemplated by the written description of the scope of an antidumping or countervailing duty order.

Micron welcomes the opportunity to comment in connection with the hearing on this subject, and looks forward to working with the Committee regarding development of rules of origin.

Sincerely,

Gilbert B. Kaplan

Gilbert B. Kaplan
Counsel to Micron Technology, Inc.

Statement of the National Knitwear and Sportswear Association
for the record in the
Hearing on Rules of Origin
Subcommittee on Trade
Committee on Ways and Means
July, 1995

This statement is submitted on behalf of the National Knitwear and Sportswear Association (NKSA) by Seth M. Bodner, its Executive Director.[1]

The NKSA appreciates this opportunity to provide brief comments for the record on the vital question of rules of origin for imported apparel.

NKSA's membership is made up of several hundred domestic manufacturers of knit apparel and fabrics of various types, and of companies providing certain affiliated services such as design, sample making and the like. Members are located in many states from the Carolinas to New England, and from New Jersey to California, Minnesota to Texas. They are predominantly smaller businesses, generally family owned, and including manufacturers, contractors and sub-contractors producing sweaters, knitted shirts, accessories and other knit apparel for a variety of labels, as well as selling under their own labels.

Summary.
NKSA believes that effective rules of origin, fully and fairly enforced, are crucial to the implementation of the trade agreements system, and particularly the textile and apparel import control program which is in place as a part of the Uruguay Round Agreements.

We believe that with minor adjustment, the Treasury Department's pending rules for textiles and apparel carry out the intent of the Congress that enacted the Uruguay Round agreements, the understandings reached with industry regarding those agreements, the needs of the total trade for clarity and fairness, the requirements of US law and the obligations of the US under the numerous international agreements in question.

The pending rules should not give rise to any obligations for adjustment of existing quotas or compensation of any kind as they do not impair the flow of trade. Countries will receive all the benefits they have negotiated, provided only that they do what was understood they were doing in the first place--i.e. making the clothing covered by the quotas.

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[1] To summarize my experience for this record, I served in the Department of Commerce in various capacities from late 1964 though 1974, during which time I worked extensively as an attorney advisor on the textile program and later directly in negotiations on countless bilateral and multilateral textile agreements. These included several extensions of the Long Term Cotton Textile Arrangements, the first bilateral agreements on wool and synthetic textiles negotiated in the Far East in 1971 and subsequently the first Multi-Fiber Arrangement covering cotton, wool and synthetic fiber textiles which was completed at the end of 1973. I was appointed Deputy Assistant Secretary for Resources and Trade Assistance in March of 1973 and chaired the Committee for the Implementation of Textile Agreements. My work at the Department was recognized with the Department's Gold Medal and my selection in 1971 for the Arthur S. Flemming Award as one of the ten outstanding young men and women in the federal service. I served two terms as a member of the and the Treasury Department's Advisory Committee for the Commercial Operations of the Customs Service. Presently, I serve on the textile ISAC (#15) and as an advisor to the textile negotiators.

Statement.
Rules of Origin have been a contentious issue for some time largely because of the powerful interest of the import community in league with foreign exporters anxious to avoid the impact of negotiated quota agreements. This interest will continue until the final demise of the quota program under the Uruguay Round in the year 2002. As some countries have found their own economic development rendering them less competitive in costs against newer countries entering the world apparel market, they have continuously sought to manipulate production to protect the value--i.e. salability of their quotas with the minimum of production input actually taking place in their territory. When that "protectionist" action has failed, they have consistently sought to negotiate or obtain the right to transfer their quota from their original country base to some other country. That has never been agreed.

The quota program involves several million US jobs, tying together the interests of companies and workers in the production of everything from raw cotton to finished apparel. The Uruguay Round deal ending the textile/apparel quota system will force a drastic shrinkage in US production. Indeed, that is occurring even now as the accelerating growth of quota and the generosity of US negotiators combine to produce ever rising imports, regardless of domestic market conditions. Manipulation of the origin rules to further expand the possibilities for imports, would render the program useless even during its final years of transition. It would drastically increase the disruption of American apparel businesses, particularly those that are smaller in scale and less able to quickly move production offshore.

From the beginning, quotas were provided to limit trade, and were based on the view that the full product was made in the country getting the quota. Over time, manipulation to affect origin determinations seems to have become as important as production; the ultimate fiasco was the evolution, unobserved by many in the industry, of "cutting only" as a basis for conferring national origin on a unit of apparel whose fabric came from another country, and whose total sewing and assembly, etc. came from still a third. Now we hear conversation regarding cutting on ships, or even planes flying between fabric producers and low cost apparel producers. What next? Space shuttle cutting with universal origin?

Domestic producers never supported such a rule, indeed most were unaware of the rulings and determinations by which Customs came to the view that cutting alone could , under the substantial transformation doctrine, determine origin. But that essentially is what happened. The recent rules, as provided by the Uruguay Round enactment legislation, correct that situation for apparel and should result in a more fair use of existing quotas. The only producers disadvantaged by that change are marginal producers with no claim to quota advantage once their production operations were moved from the original quota holding country.

For Knit to Shape garments, a primary concern of our sweater knitting members, the rules had been clarified to provide origin based on the country of knitting, and this was not changed in the Uruguay Round legislative prescriptions for Treasury. (It is worth recalling that when the original version of this rule was proclaimed, some Far East producers immediately started presenting Customs with scenarios based on a series of truly absurd "what ifs" -- absurd in the sense that sweater producers don't

typically knit sleeve and bodies in two different countries and send them to a third for assembly and a fourth to inspect/pack and ship.)

As we advised Customs in the most recent iteration of the origin rules, for all products, a sensible and realistic provision, for Quota purposes, would be based on the idea that "... complete production from the fabric forward should be required to take place in a single country in order for the garment to successfully claim origin from that country.

"Original quota agreements specified that export restraints applied to goods which were "produced or manufactured in..." Multi-country production of individual garments was not part of the negotiating environment and surely was not part of the original intention. It was not a U.S. negotiating purpose to establish quotas on exports from country X, for example, only to have that country sub-contract much if not all, of the actual work to country Y." (NKSA filings with Treasury Department dated June 16,1994, with supplement of June 20, 1995)

Our position was as follows on "knit to shape garments, where the process of manufacturing involves both the simultaneous production of fabric and essentially shaped parts, as well as their subsequent looping (or linking) or sewing, the preferred rule in quota administration terms would be to require both knitting and full assembly to be done in the same country. There is no valid production reason for having these operations done in separate countries, even if they are occasionally done in separate facilities of the same company."

When adopted in 1985, the rule essentially established the place of knitting as the place of origin, thereby correctly focusing on the key element in the process in terms of traditional substantial transformation rulings. However, by permitting assembly to move from country-to-country without affecting the origin status of the final goods, the rule appears to have encouraged an "un-natural" non-economic and multi-country separation of real production processes from quota holding. We believe this separation has encouraged quota cheating through mislabeling of the true origin of goods even as defined under the extant knit to shape rule. In essence, we believe these situations should be handled under a modified rule dealing with non-qualifying production operations performed with the intention of affecting the origin determination for quota purposes."

We recognize that there are different issues affecting quota rules and Customs tariff and marking rules, and that it could be possible to provide one rule for quota purposes and another for tariff purposes. We also understand that Customs, for tariff/marking purposes, must answer an origin request, even if the garment is produced in sixteen separate operations each in a separate country solely to "engineer" itself out of one or another government regulation. (Our recent Supplementary filing on these rules attempted to clarify this point.) But we also believe that such manipulation or "tariff engineering" should be discouraged by rule writing, not encouraged by it.

To this end, we especially supported a provision which would disallow, for classification purposes, operations that appeared from reasonable evidence, to have been undertaken for the primary purpose of affecting origin determinations as opposed to sound industrial practice.

Conclusion

Recent legislation to implement the Uruguay Round did not involve opposition by our industry because of the understandings embodied in the origin rule provisions. Our view was that for cut and sewn apparel, assembly was the critical step, and for knit to shape apparel, knitting was the essence. The Uruguay Round enactment legislation carried out that understanding. To undo those rules now, whether through new legislation or deliberate erosion at the Customs level, or erosion in the process of reaching international agreement on more general rules of origin as part of the new WTO work program, would be a major breach of faith with the domestic industry and workers.

Foreign countries with quota surely have no claim to compensation for rules that permit them to continue shipping growing amounts of apparel actually made within their territorial borders. Indeed, many will benefit from an end of the advanced gamesmanship being played which simply protects the quota holdings of some non-economic former producers while preventing new comers from achieving value for their own quota. Those feigning loss and demanding "compensation" need only look at their own real production, wean their quota farmer "manufacturers" from dependence on the super-low-wage production of the Peoples Republic of China, and re-institute local factory production that was the real basis for the original quotas, to receive total value from their quota holdings. To permit otherwise is to throw out the quota system which is integral to so many of the the remaining jobs in US textile and apparel production while incidentally undercutting the value of quota negotiated by newer entrants into the world apparel markets.

Finaly, the Committee should be wary of proposals to unify all origin rule determinations, regardless of the statutory purpose for which such rules exist, just in the name of simplification and ease of Customs administration. Rules of origin have been in various forms for various purposes for many years. Simplification is fine--and we supported the tariff shift approach for that reason--provided it does not sacrifice the specific policy goals involved. Customs administration is not an end in itself, and the convenience of the administrators surely must be a secondary if not lesser consideration to the effectiveness for the policy ends contemplated by the statute or program.

Thank you for receiving this testimony and including it as part of the record.

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BEFORE THE
HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE

STATEMENT OF NATURAL FEATHER AND TEXTILES INC.
AND PAC FUNG FEATHER COMPANY
CONCERNING RULES OF ORIGIN

Natural Feather and Textiles, Inc. ("NFT"), and Pac Fung Feather Company, Limited ("Pac Fung"), appreciate the opportunity to present views to the House Ways and Means Trade Subcommittee concerning the operation of rules of origin which have been proposed by the United States Customs Service. For the reasons detailed herein, NFT and Pac Fung submit that the Congress should review Customs' pending rules of origin proposals, and issue guidelines to the agency which will insure that rules of origin will not impose unreasonable burdens or expenses on United States businesses or consumers. Congress should also assure that United States rules of origin and origin marking requirements do not become nontariff barriers, which might invite retaliatory action by United States trading partners.

Congress has proposed two sets of origin rules which could have a significant impact on NFT and Pac Fung. These are:

1. Customs' proposal to amend the NAFTA Annex 311 Marking Rules, which operate on "tariff shift" principles, and to adopt those rules as a "universal" origin marking code; and

2. Customs' proposed rules of origin for textile and apparel articles pursuant to Section 334 of the Uruguay Round Agreements Act (URAA), the so-called "Breaux/Cardin" amendment. These rules, if enacted, could drive NFT and Pac Fung out of business.

In addition, Customs' administration of its existing "substantial transformation" rule of origin has been inconsistent, at least with respect to home textile products of the kind sold by NFT and Pac Fung.

Interest of Commenters

Pac Fung is an established Hong Kong-based manufacturer of downproof comforter shells, as well as duvet covers, bed sheets, pillow shells and other home textile and bedding articles. The company manufactures these goods at factories located in Hong Kong, The People's Republic of China and Macau. In most cases, the fabrics used in the manufacture of these articles are woven, or woven and finished, in the People's Republic of China. This is particularly true in the case of "downproof" fabrics, which are used in the manufacture of comforter shells. "Downproof" fabrics have an extraordinarily high thread count (as many as 300 yarns per inch) and are woven tightly together to prevent processed down from migrating through the fabric. They are only manufactured in commercially significant quantities in three countries (China, India and Germany), and are not produced in significant amounts by textile mills in the United States.[1]

Pac Fung is one of the leading suppliers of downproof comforter shells to the United States market. These shells are used by United States manufacturers in the production of

[1] United States textile mills are extremely large, high-capacity mills which are geared to producing enormous quantities of "commodity"-type sheeting fabrics, rather than specialty fabrics such as downproof goods, which are consumed in much smaller quantities. Domestic textile producers have historically shown no interest in manufacturing specialized fabrics for the downproof market sectors.

finished down-filled comforters and featherbeds. Generally, the comforter shells are filled with processed down or feathers of United States origin.

NFT is Pac Fung's selling agent and representative in the United States market, which accounts for the major proportion of Pac Fung's worldwide sales.

Analysis

1. **The "Tariff Shift" Principles Advocated by Customs Do Not Provide a Fair Basis for a Nonpreferential Rule of Origin, Unless Supplemented by the Principle of "Substantial Transformation" or Other Principles Grounded in Commercial Practice.**

Traditionally, imported goods were considered to originate in the country where they last underwent a "substantial transformation" prior to importation in the United States. A "substantial transformation" was said to occur whenever, by means of manufacturing or processing, a new article of commerce emerged, having a name, character or use different than its constituent materials. United States v. Gibson-Thomsen Co., Inc., 27 CCPA 267 (1940). Customs has applied the "substantial transformation" principle on a case-by-case basis, according to the facts applicable to each operation considered. While the "substantial transformation" test is not an entirely objective one, it has worked fairly well, and its application to particular classes of goods are well understood by the affected industries.[2] The "substantial transformation" concept is consistent with rules of origin maintained by most of the United States' trading partners.

In recent years, however, the Customs Service has made it a priority to move away from the "substantial transformation" concept, in favor of rules of origin based on "tariff shift" principles. Under these principles, where, by reason of manufacturing or processing, a product undergoes a change in classification from one heading of the Harmonized Tariff Schedule of the United States to another specified heading, it is considered to have become a new article of commerce, which has undergone a change of origin. Commercial practice is unimportant; only a required change in tariff nomenclature will confer origin. Tariff-shift principles have been used to administer trade preference regimes (such as Annex 401 of the North American Free Trade Agreement), as well as the NAFTA Annex 311 Marking Rules. Both of Customs' pending rule of origin initiatives -- the "universalization" of the NAFTA Annex 311 marking rules, and the Section 334 textile origin rules -- rest on "tariff shift" principles.

However, we submit that "tariff shift" rules, taken alone, will not recognize all commercially important operations which create new and different goods, and which should be recognized as conferring a change in origin. While "tariff shift" rules of origin may in certain instances be reasonable, they should not be applied as a substitute for the traditional "substantial transformation" principle. The Harmonized System of Tariff Nomenclature was devised as a system for listing goods bought and sold in international trade, and not for identifying commercially significant manufacturing and processing operations which effect a change in a product's identity, character, or use. Some four-digit tariff headings or six-digit headings may be exceptionally broad in coverage; materials may undergo commercially significant changes without a correlative change in tariff classification. Other tariff headings and subheadings are narrowly drawn, and are often limited to a single chemical substance or manufactured good. The disparity in scope and coverage of tariff headings necessarily limits the usefulness of "tariff shift" rules of origin. While it is possible to specify tariff shifts which would require a high degree of manufacturing or processing (e.g., as in the NAFTA Annex 401 Preference Rules), it is much more difficult -- if not impossible -- to set tariff shift rules which will recognize all commercially

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[2] That the "substantial transformation" rule has worked relatively well is underscored by the fact that, in over half a century, only about two dozen Court decisions have been rendered addressing the rule.

important manufacturing and processing operations[3].

Furthermore, tariff nomenclatures such as the Harmonized System are written with reference to current technology. Subsequently-developed goods -- which may involve substantial manufacturing and commercial advancements -- are often classified under tariff headings which provide for more rudimentary articles. A change in tariff classification may be indicative of a change in an article's identity, name, character or use, but it is not an accurate indicator of such a change.[4]

For this reason, NFT and Pac Fung submit that, if Customs proceeds adopts the NAFTA Marking Rules as the basis for a uniform country of origin regulation, it should provide that the designated tariff shifts are prima facie indicators that a "substantial transformation" has occurred. However, Customs should also adopt "supplemental principles" which would allow importers or domestic manufacturers whose goods do not undergo a specified tariff shift to demonstrate a change in origin based upon the traditional "substantial transformation" principle, which requires a showing that a new and different article of commerce has been created, having a name, character or use different from that of its constituent materials or parts.

Such an approach would be consistent with that indicated by statute. As noted above, Section 207(a)(4) of the NAFTA Implementation Act clearly indicates that the Annex 311 Rules are not intended as a substitute for the "ultimate purchaser/substantial transformation" origin marking exception contained in Section 304(a)(3)(H) of the Tariff Act of 1930, as amended [19 U.S.C. Section 1304(a)(3)(H)]. The statute provides that, notwithstanding adoption of the NAFTA Annex 311 Rules, the "ultimate purchaser/substantial transformation" marking exception will continue to apply to goods imported from all countries. Indeed, the NAFTA Implementation Act established a new subsection (h) to Section 304, which requires that the "ultimate purchaser/substantial transformation" test be applied to goods of NAFTA countries on a somewhat more liberal basis than to goods of other countries.[5] This reaffirmation of the statute is clear evidence of Congressional intent that the traditional "substantial transformation" test, as enunciated by the courts [see, e.g., United States v.Gibson-Thomsen Company, Inc., 27 CCPA 267 (1940)] continue to remain in effect, and be applied by Customs. Neither the NAFTA Implementation Act, nor any subsequent legislation, has indicated any Congressional intent to deviate from the established, commercially-realistic standard for recognizing a change in the origin of a good.

It is also worth noting that the United States' proposal for nonpreferential origin rules under the Uruguay Round Agreement on Rules of Origin advocates the use of "tariff shift" rules of origin, but with "supplemental principles" which will recognize changes in the origin of

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[3] For example, nobody would deny that a stencil duplicating machine and a pencil sharpener are different articles of commerce, having quite different names, characters and uses. Yet both are classified in the HS heading 8472. If it were possible to transform one of these articles into another, there is no doubt that a new and different article of commerce would emerge; however, the "tariff shift" rules would not recognize it as such.

[4] "While the fact that by a manufacturing effort expended on an article its tariff status may have been changed is a proper matter to consider along with other circumstances in arriving at a conclusion as to whether the article has been manufactured or produced, it certainly should not be a controlling consideration". Roland Freres, Inc. v. United States, 23 CCPA 81, 85 (1935).

[5] The statute requires that, in the case of goods imported from NAFTA countries, a marking exception will be granted if an "ultimate purchaser", by reason of the nature of the goods or the circumstances of their importation, "must reasonably know" their origin. For goods of non-NAFTA countries, Section 304(a)(3)(H) continues to grant a marking exception where the ultimate purchaser "must necessarily know" their origin.

goods when commercially important transformations are not accompanied by a change in tariff classification.

In its Notice of Proposed Rulemaking regarding the universal adoption of NAFTA Rules of origin, the Customs Service has taken pains to argue that its "tariff shift" rules of origin represent a codification of the principle of "substantial transformation", as traditionally applied by Customs and the courts[6]. Indeed, Customs notes at great length that its "tariff shift" rules are consistent with "substantial transformation" decisions issued by the courts in approximately two dozen cases.

Even if this is so, however, it must be remembered that these cases dealt with a relatively few commercial operations. There are tens of thousands of other commercial operations which have not been the subject of "substantial transformation" rulings by the Courts or, for that matter, by the Customs Service. It would be folly to think that Customs' proposed regulations can accurately predict these multifarious operations and accurately identify all in which a commercially significant change in identity occurs.

Congress should furnish Customs with guidance that the "substantial transformation" rule should not be abandoned.

2. Congress Has Not Delegated General Authority to Customs to Codify Rules of Origin

Under the Constitution, Congress has the power to regulate international commerce. With few exceptions [such as Section 334 of the Uruguay Round Agreements Act], Congress has not given Customs any direct or implied authority to substitute its judgment for that of the legislature or the courts in making country of origin determinations. However, by attempting to promulgate the NAFTA Annex 311 Marking Rules as a universal origin code, Customs is attempting to do just that. By attempting to do so, Customs is in fact usurping the authority of both Congress and the Courts. This was demonstrated at the Trade Subcommittee's June 11, 1995 public hearing, at which administrative officials admitted that they had no specific mandate from Congress to replace the statutory "substantial transformation" principle with tariff shift rules. It was further demonstrated by the testimony of an Administration witness concerning the role of the Courts in reviewing origin determinations rendered under codified origin rules. The witness indicated that the Courts would no longer review the operation in question, but would instead determine whether the Customs regulation applied to it was a "reasonable" regulation. Clearly, Customs is attempting to change the standard of judicial review accorded to marking

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[6] In the case of home textile articles, Customs has not written its tariff shift rules to comply with the traditional application of the "substantial transformation" rule, but has instead rewritten history to conform to its proposed rules. Traditionally, Customs recognized, for example, that filling a comforter shell with down or feathers to make a finished comforter was a "substantial transformation" of the shell. See., e.g., New York Customs Ruling 899334 of July 22, 1994. This traditional rule was reflected in Customs' initial proposed NAFTA Marking Rule. Later, when domestic comforter fillers were proposing the adoption of a "shell forward" rule of origin, Customs reversed its position and held that filling a comforter shell did not "substantially transform" it. Customs Headquarters Ruling 956320 of December 12, 1994. More recently, when the agency determined that its NAFTA Marking rules would not feature a "shell forward" origin rule for down- and feather-filled comforters, it reversed its position again, holding that the filling of a downproof comforter shell was a substantial transformation! Customs Headquarters Ruling 957472 of April 25, 1995.

Such a dizzying pattern of reversals -- in a period of just 10 months -- undercuts Customs' assertion that its proposed NAFTA Marking Rules comport with long-established commercial and administrative practices.

determinations, and is usurping the authority which Congress has conferred on the judiciary[7].

In the course of day-to-day Customs business, Customs must necessarily make on-the-spot determinations regarding country of origin for a variety of purposes; importers who disagree with those determinations have recourse to the courts for review, under the "substantial transformation" standard. There is no indication that Congress delegated additional power to Customs to make origin determinations, changed the standard for such determinations, or authorized Customs to usurp the role of the courts in making such determinations.

3. Customs' Proposed "NAFTA Marking Rules" for Home Textile Articles Do Not Reflect Commercial Reality

Customs has proposed adopting its NAFTA Annex 311 Marking Rules, with suggested amendments, as a universal country of origin code. In the case of home textile articles, these rules would apparently be supplanted, effective July 1, 1996, by the origin regulations promulgated under Section 334 of the Uruguay Round Agreements Act, which would impose a "fabric forward" rule of origin for all home textile goods. Even though the NAFTA Annex 311 origin rules might apply to home textiles only briefly, a quick review of some of them shows that they are out of touch with commercial reality.

A. HTS Headings 6302 and 6304 (Bed Linens and Other Furnishings)

Customs' proposed rules of origin for goods classified under headings 6302 and 6304 would require that (except for quilted goods), bedding articles and accessories manufactured in one country using fabric which originates in another country would be considered to have undergone a "substantial transformation" if they undergo a change in tariff classification that "is the result of cutting finished fabric on all sides and hemming all cut edges plus at least one other subsequent process, with no consideration being given to the addition of minor embellishments". According to Customs, this requirement "clarifies the fact that fabric finishing operations are not considered [in making origin determinations] and eliminates any uncertainty regarding the minimum amount of hemming that must be performed." Thus, cutting and hemming on all four sides, plus additional processing, would be required in order for fabric to undergo a change in country of origin when converted to bedding or furnishing articles.

This proposed rule does not focus on whether a new and different article of commerce is created, but rather on the quantity of work performed in a given country. There is no doubt that cutting fabric and hemming on all four sides to create a bedsheet yields a new and different article of commerce, with a different name, character, and use than the bulk fabric. However, Customs' rule fails to confer origin until more is done -- until a bedsheet is ornamented, for example. The rule fails to acknowledge the major change in commercial identity

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[7] The present situation should be distinguished from that presented in Mast Industries, Inc. v. United States, 8 CIT 214 (1984), which involved a challenge to Customs' existing rules of origin for textile and apparel articles [19 C.F.R. Section 12.130]. In that case, the Court held that Congress had specifically delegated authority to the Executive Branch [pursuant to the Agricultural Adjustment Act, 7 U.S.C. Section 1854] to make policy with respect to the imposition and administration of restraints on textile and apparel imports. The regulations at issue in that case were limited to quota administration purposes. In the instant case, by comparison, the power to regulate international commerce resides with Congress under the United States Constitution. There is no indication that Congress has delegated that authority to the Executive Branch, except with respect to country of origin marking matters, as noted in 19 U.S.C. Section 1304(a)(3)(H). With respect to that delegated authority, Congress has enunciated a standard for Executive branch action [the "ultimate purchaser/substantial transformation"] test, and has approved the interpretation of that standard by the Courts. Customs has not been given Congressional sanction to replace that standard with another.

(from bulk fabric to sheet), but instead hinges on a minor change (from unornamented sheet to ornamented sheet). This is subjective (the type of rule which a nation might adopt to protect one of its domestic industries), and commercially unreasonable.

To its credit, this rule recognizes that operations performed upon greige and/or finished textile fabrics can result in the creation of new and different articles of commerce.[8] However, the proposed rule would not recognize some fundamental commercial distinctions.

B. HTS Heading 6307.90 (Comforter Shells)

Customs has proposed that a change to subheading 6307.90 from any other heading should be considered sufficient to effect a change in origin, provided the change is the result of at least cutting and a "substantial" amount of sewing and assembly operations. Here again, such a test cares less about whether a new article of commerce is created, than the quantity of work expended in creating it.

What constitutes "substantial" assembly is a subjective test which Customs has not articulated. Absent a clear definition of what quantum of sewing is "substantial" in a given case, the rule furnishes business with less guidance and predictability than the substantial transformation rule[9].

C. HTS Heading 9404 - Comforters, Quilts, Etc.

Customs has proposed sweeping changes to the interim NAFTA Marking Rule governing comforters, quilts and other articles of heading 9404.

For goods classified in headings 9404.10 through 9409.29 (mattresses and mattress supports) a simple tariff shift at the four-digit tariff heading level will be sufficient to confer origin. For goods classified in headings 9404.30 through 9404.90, however (sleeping bags, quilts, eiderdowns, cushions, pouffes and pillows) Customs is proposing a multi-tiered rule of origin, which provides substantially as follows:

> (1) For goods which are filled with down or feathers, the filling of the shell will be deemed to effect a sufficient transformation to change origin;
>
> (2) Where goods are filled with substances **other than feathers or down**, filling will not be deemed to confer origin. Rather, origin will be conferred in "the country where **all** cutting and sewing operations required to form the outer shell were performed" -- in

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[8] By contrast, the "fabric forward" rules of origin for home textile products of HTS Chapter 63 which have been proposed under Section 334 of the Uruguay Round Agreement Act do not recognize this distinction, and would fix the origin of all such goods as the country where their constituent textile fabric components were woven in the greige.

[9] For example, comforter shells are manufactured in different grades, which feature different levels of structural complexity. Some shells are little more than "bags", which are sewn entirely closed on three sides, and partially closed on the fourth. Others feature "baffle" construction and contain internal structures which serve to provide partial internal compartmentalization (and even distribution of filling) for the finished products. Baffle sewing requires different machinery and sewing techniques than the sewing which is done to close the outer edges of the shell, and is often accomplished in different factories. What degree of sewing should be required to confer origin on these different grades of comforter shells?

effect, a "shell forward" rule;

(3) For goods filled with substances other than feathers or down, if all cutting and sewing operations required to form the outer shell were not performed in a single country, the country of origin will be "the single country where the component of the outer shell which determines the classification of that good was produced" -- in effect, a "fabric forward" rule; and

(4) If no single country produced the fabric forming the outer shell, the country of origin will be the last country in which the good underwent a "substantial assembly" process. What constitutes a "substantial assembly" is obviously an objective determination.

While NFT and Pac Fung agree that the rule proposed for goods which are intended to be filled with feathers or down (i.e., "downproof" goods) is appropriate, it is difficult to understand why the operation of filling a comforter or quilt shell with materials other than down or feathers is not considered sufficient to impart a new commercial identity to a product, or to work a change in a product's country of origin. Certainly, a fiber-filled comforter is as different an article from its constituent shell as is a down-filled comforter. The fact that Customs would attempt to draw such fine distinctions in a supposedly objective rule of origin indicates how tariff shift rules, without being supported by a supplemental principle such as "substantial transformation", can be twisted to protect domestic industries, exclude goods produced in particular foreign countries, or otherwise be used as mechanisms to advance policies unrelated to the purposes of nonpreferential rules of origin.[10]

In sum, the NAFTA Annex 311 marking rules, standing alone, do not provide an adequate basis for a universal rule of origin. However, if Customs were to adopt the rules to identify operations which prima facie effect a change in origin, while allowing traders whose operations do not meet these rules to demonstrate, on a case-by-case basis, that the operations effect a "substantial transformation" for origin purposes, the system would be unobjectionable. It would allow for the recognition of all commercially significant operations.

Such a "two-tiered" system would comport with the United States' proposal in the Uruguay Round Rules of Origin Study. While it would not eliminate the need for Customs to issue interpretive rulings concerning country of origin and marking issues, it would substantially reduce the number of instances where traders would need to seek such rulings. Congress should direct Customs to retain the "substantial transformation" principle as a "bottom line" rule of origin.

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[10] We also note that the NAFTA Annex 401 preference rules of origin recognize that the filling of a comforter, quilt or pillow shell to create a finished bedding article of HTS heading 9404 is a sufficiently important operation to confer "originating" status for NAFTA tariff rate purposes. To the extent that Customs' revised proposed rules for goods which are not down-or-feather-filled provide otherwise, they conflict with the requirements of NAFTA, and create an anomalous situation where the nonpreferential rule of origin is more difficult to satisfy than the preferential rule.

4. Customs' Proposed Rules of Origin for Home Textiles under Section 334 of the Uruguay Round Agreements Act Violate Congressional Intent, Threaten U.S. Businesses With Financial Ruin and Threaten to Limit Supplies of Needed Products

In Section 334 of the Uruguay Round Agreements Act, Congress did give Customs specific authority to issue country of origin regulations for textile and apparel products, and furnished guidance concerning the rules to be issued. However, Customs has proposed a "fabric forward" rule of origin for all home textile articles -- a result which Congress could not have intended and which, if implemented, would destroy NFT and Pac Fung.

NFT and Pac Fung are among the United States largest suppliers of 100% cotton downproof comforter shells. The specialized downproof fabric used to make these shells is produced in only three countries -- China, India and Germany. Because China's quota for downproof cotton goods is oversubscribed (ironically, comforter shells compete for quota with finished goods, such as down-filled comforters and duvet covers), Pac Fung has long operated plants in Hong Kong, and more recently in Macau, which produce comforter shells from Chinese-fabric. However, if Customs' proposed "fabric forward" rule of origin is adopted, comforter shells produced in all three countries would be deemed products of China for quota purposes. NFT and Pac Fung would effectively be excluded from the United States market. NFT would almost certainly be forced to shut down. Even with its sales to other markets, Pac Fung's continued existence would be in jeopardy.

We submit that Customs' proposed "fabric forward" rule springs from a fundamental misunderstanding of what Congress intended when passing Section 334 of the Uruguay Round Agreements Act. Congress should instruct Customs to revise its regulations.

Section 334(b) of the Uruguay Round Agreements Act establishes the principles which must Congress intended to be incorporated in Customs' origin regulations. The "general principles" provide that a product will be considered to originate in a country, territory or insular possession if:

> (A) The product is wholly obtained or produced in that country, territory or possession;
>
> (B) **The product is a yarn, thread, twine, cordage, rope, cable, or braiding** and --
>
> > (i) The constituent staple fibers are spun in that country, territory or possession, or
> >
> > (ii) The continuous filament is extruded in that country, territory or possession;
>
> (C) **The product is a fabric**, including a fabric classified under Chapter 59 of the HTS, and the constituent fibers, filaments or yarns are woven, knitted, needled, tufted, felted, entangled, or transformed by any other fabric-making process in that country, territory or possession; or
>
> (D) The product is any other textile or apparel product that is wholly assembled in that country, territory or possession from its component pieces.

Subsection (D) noted above, is the keystone of Section 334. It provides, in effect, that where an apparel article is sewn in one country from fabric or garment parts formed or cut in another country, the country of sewing assembly will be the country of origin. This is a marked

departure from Customs' current regulations [19 C.F.R. Section 12.130], which provide generally that an apparel article derives its origin from the country in which fabric is cut to form the garment's constituent parts.

Section 334 (b)(2) of the Act recognizes that the "assembly" rule of Section 334(b)(1)(D) may not be appropriate for determining the origin of certain enumerated textile products, and provides "special rules", including a provision that:

> (A) The origin of a good that is classified under one of the following HTS headings or subheadings shall be determined under subparagraph (A)(B) or (C) of paragraph (1), **as appropriate**: 5609, 5807, 5811, 6209.20.50.40, 6213, 6214, 6301, 6302, 6303, 6304, 6305, 6306, 6307.10, 6307.90, 6308 or 9404.90.

Furthermore, Section 334(b)(3) provides the following "multicountry rule":

> (3) MULTICOUNTRY RULE.
> -- If the origin of a good cannot be determined under (1) or (2), then that good shall be considered to originate in, and be the growth, product or manufacture of
>
> > (A) The country, territory or possession in which the most important assembly or manufacturing processing occurs, or
> >
> > (B) if the origin of the goods cannot be determined under subparagraph (A), the last country, territory or possession in which important assembly or manufacturing occurs.

Customs' proposed regulations would subject sheets, duvet covers, furnishings, comforter shells, comforters and other "enumerated goods" of Section 334(b)(2)(A) to a "fabric forward" rule of origin. The origin of a good would be the country where its constituent fabric was woven in the greige. No recognition would be given to any subsequent fabric-finishing operations, design work, cutting and sewing, addition of embroidery, or addition of non-textile materials, such as down. Under the rules, the origin of a $200 down-filled comforter might be deemed to be the country where $4 worth of fabric used in its manufacture was woven.

Customs' proposed "fabric forward" rules of origin for home textile articles represent a marked departure from any other origin rule ever applied ot home textiles.

Although home textiles and the other enumerated goods of URAA Section 334(b)(2)(A) are not subject to the "assembly" rule of Section 334(b)(1)(D), the statute requires their origin to be determined according to rules set out at Sections 334(b)(1)(A) through (C) "as appropriate". For example, enumerated articles which are produced in a single country would be subject to Section 334(b)(1)(A). Enumerated articles which are "fabrics" or "yarns" would be subject to Sections 334(b)(1)(B) or (C). Where enumerated goods do not fit these rules, it is not "appropriate" to determine their origin pursuant to Section 334(b)(1)(A-C)[11]; it is, however,

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[11] The Customs Service, in its Notice of Proposed Rulemaking, has suggested that Sections 334(b)(1)(B) and (C) cannot be limited to goods which are "yarns" or "fabrics", but must instead be read expansively to encompass the enumerated articles of Section 334(b)(2)(A). Customs' rationale is that failure to adopt an expansive interpretation would render Section 334(b)(2)(A) a "nullity", since the articles enumerated therein, (whose origin is to be determined in accordance with Section 334(b)(1)(A-C) "as appropriate") have all been advanced beyond the stage of a mere "yarn" or "fabric".

Customs' analysis in this regard is incorrect. To the extent that any "enumerated articles" are manufactured in a single country, their origin would be determined according to Section 334(b)(1)(A). Furthermore, there are some enumerated articles which are, in effect, mere "fabrics". These might include fabric labels (HTS heading 5807), which are classified in a tariff

appropriate to resort to the "multicountry rule" of Section 334(b)(3).

NFT and Pac Fung presented their views on this issue to the Treasury Department in a "White Paper" circulated while the proposed Section 334 regulations were being drafted. Customs specifically rejected these views in its Notice of Proposed Rulemaking, stating:

> The words "as appropriate" in Section 334(b)(2)(A) of the Act appear to have created some confusion regarding the application of that statutory provision. In this regard it has been suggested to Customs, for example, that because neither a bed sheet or a comforter (each of which is classifiable in a tariff provision listed in Section 334(b)(2)(A) is a fabric, it would not be appropriate to determine the origin of a sheet or comforter by resorting to subparagraph (1)(C) which on its face covers only fabric. Customs does not agree with this suggested interpretation because all of the HTSUS provisions listed in Section 334(b)(2)(A) cover goods that have been advanced beyond the form of in other words, have been made from yarn, thread, etc or fabric. Accordingly, the suggested interpretation would make a nullity of Section 334(b)(2)(A).
>
> Customs believes that the words "as appropriate" in Section 334(b)(2)(A) are simply intended to alert the reader to use common sense. For example, when determining the origin of a bed sheet cut and finished in Country B from fabric woven in Country A, the appropriate rule is subparagraph (1)(C) which concerns the origin of fabrics.
>
> * * *
>
> The proposed tariff shift rules set forth in this document for goods classified in the HTSUS provisions enumerated in Section 334(b)(2)(A) of this Act have been drafted to reflect this position.

60 Fed. Reg. at 27382.

This interpretation of the statute is clearly incorrect. The words "as appropriate" in Section 334(b)(2)(A) of the URAA constitute limiting language. The words indicate that the origin of the enumerated articles is to be determined according to the rules of Section 334(b)(1)(A-C) when it is "appropriate" to do so. Thus, reference to Section 334(b)(1)(A) is appropriate when the enumerated article is produced wholly in a single country. Reference to Section 334(b)(1)(B) or (C) is appropriate when "the product is a yarn, thread, twine, cordage, rope, cable, or braiding" or "the product is a fabric". Otherwise, reference to the multicountry rule of origin of Section 334(b)(3) is appropriate.

Commenters submit that Customs' interpretation of the statute with respect to the enumerated goods of Section 334(b)(2)(A) is fundamentally erroneous.

Legislation must be interpreted so as to carry out the intent of the legislature. See, e.g., United States v. Clay Adams Co, Inc., 20 CCPA 285, T.D. 46078 (1932); Brecht Corp. v. United States, 25 CCPA 9, T.D. 48977 (1937), cert. denied, 302 U.S. 719 (1937). "The first source for the determination of that intent is the statutory language, which is presumed to be used in its normal sense." Sturm, Customs Law and Administration, 3d. ed. at Section 51.3, p. 35; see

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chapter for fabrics, some diapers of heading 6209.20.50.40 (particularly those produced in a single piece and having edges which are selvaged, not hemmed), some handkerchiefs of heading 6213, some items classified as scarves of heading 6214, blankets of heading 6301 or furnishings of heading 6304 (e.g., fabric wall hangings with edges that are fringed but not hemmed).

also United States v. Gulf Oil Corporation, 47 CCPA 32, C.A.D. 725 (1959); United States v. Esso Standard Oil Co., 42 CCPA 144 (C.A.D. 587 (1955). "If the language is clear and unambiguous, there is no reason why its meaning should be rejected, and a search diligently made for some other signification". Sturm, supra, at Section 51.3, p. 35; see also Akawo, Morimura & Co. v. United States, 6 Ct. Cust. Appls. 379, 381, T.D. 35921 (1915). Unless a construction adhering to the plain language of the statute produces absurd or anomalous results, the statutory language must be applied according to its plain meaning. See, e.g., Intercontinental Fibres, Inc. v. United States, 64 CCPA 31 (1976).

In Section 334 of the Uruguay Round Agreements Act, Congress has given quite specific directions concerning the rules of origin that should apply to particular imported textile and apparel articles. Section 334(b)(1)(A) of the URAA provides that an article originating entirely in one country is to be deemed a product of that country. Section 334(b)(1)(B) provides that "if the product is a yarn", etc., and is produced in two or more countries, its origin is to be determined according the country where it was spun or extruded. This rule reflects a Congressional recognition that, even where a yarn is produced in two or more countries, the single operation of spinning is what creates the article, and should govern origin determinations (to the exclusion of other operations, such as dyeing or bleaching). Similarly, Section 334(b)(1)(C) recognizes that "if the product is a fabric", the fabric-forming operation is the defining one, and should govern origin.

Although Congress' expressed limitations on the scope of Sections 334(b)(1)(B) and (C) are quite specific, Customs' proposed regulations (and the agency's rationale for them) suggest that the use of the term "as appropriate" later in the statute requires that the plain language of the statute be discarded and a more expansive interpretation applied. Thus, the proposed regulations for home textiles would interpret Section 334(b)(1)(C) to cover instances where "the article is a fabric **or a product specified in Section 334(B)(2)(A) which is composed of fabric or which, by application of 'common sense' can be analogized to a fabric.**" Such an absurd interpretation is contrary to well-established rules of statutory construction. It is well settled that "general language in one part of a statute will not be held to modify specific language in another part unless such modification is expressly stated or clearly implied." Sturm, supra, at Section 51.6, p. 59. See also United States v. Siegfried Lowenthal Co., 31 CCPA 19, C.A.D. 244 (1943).

Had Congress so wanted to expand the application of Sections 334(b)(1)(B) and (C), it could have easily used language to so specify. Instead, it indicated that the origin of the enumerated goods of Section 334(b)(2)(A) was to be determined with reference to these rules "as appropriate" -- a condition which indicates Congress' view that, in some cases, it will not be appropriate to use these rules.

Clearly, Congress indicated that the "assembly" rule of Section 334(b)(1)(D) was not to be applied to the enumerated articles of Section 334(b)(2)(A). However, there is absolutely nothing in the statute or its legislative history which indicates an intention to preclude application of the "multicountry rule" of Section 334(b)(3) to these goods. Congress carefully chose specific language to make the "assembly in a single country" rule of Section 334(b)(1)(D) inapplicable to the enumerated articles; had it wished to make the multicountry rule inapplicable to such articles, it could have specifically so provided. That it did not include such language in the statute indicates that no such limitation was intended.

In addition to threatening NFT and Pac Fung with dissolution, Customs' proposed "fabric forward" rule of origin for home textiles and other "enumerated" articles would effectively constitute a "nullification and impairment" of United States tariff concessions made to several of our trading partners in respect of these articles. It would erect a barrier to certain goods presently being imported (e.g., comforter shells made in Hong Kong and Macau), and would violate the requirements of the Uruguay Round Agreement on Rules of origin respecting "interim" origin regimes.

Congress should direct Customs to revise its proposed Section 334 origin rules so that, in appropriate cases, the origin of home textile articles may be determined with reference to the "multicountry" rule of origin specified in the statute. This would comport with

Congressional intent, and would avoid the dire consequences posed by Customs' current proposal.

Conclusion

The "substantial transformation" origin rule which Congress has expressly sanctioned, and which Customs has traditionally applied, is imperfect, but produces commercially realistic, acceptable results in virtually all cases. Congress should direct Customs to continue applying the "substantial transformation" principle in determining the origin of imported goods, pending the completion of the Uruguay Round Rules of Origin Study, and the adoption of uniform international origin rules.

If Customs wants to adopt the "tariff shift" principles set out in the NAFTA Annex 311 Marking Rules as examples of operations which prima facie work a substantial transformation, this would be acceptable, provided firms whose goods do not undergo one of the specified tariff shifts are permitted to demonstrate that the goods undergo a "substantial transformation". This small amendment to Customs' proposal would allow the agency to realize its goals (simplifying administration of origin rules, reducing interpretive rulings, implementing a working origin code), without resulting in commercially unreasonable determinations which will harm domestic industries. It would also allow Customs to identify ways in which its "tariff shift" rules might be refined, and thereby become more inclusive. Congress should direct Customs to proceed in this manner.

Congress should also direct Customs to amend its proposed origin rules for textiles and apparel under Section 334 of the Uruguay Round Agreements Act, to eliminate the proposal that a "fabric forward" rule of origin be applied to all home textile products.

We thank the Subcommittee for considering these comments, and stand ready to furnish any further information which may be required.

Respectfully submitted,

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July 21, 1995

[BY PERMISSION OF THE CHAIRMAN]

TESTIMONY OF ACTING GOVERNOR JESUS C. BORJA
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS
Before the
COMMITTEE ON WAYS AND MEANS
UNITED STATES SENATE/HOUSE
July 26, 1995

I appreciate this opportunity to submit written comments on behalf of the Commonwealth of the Northern Mariana Islands (CNMI) regarding the U.S. Customs Service's proposed non-preferential rules of origin, particularly as they relate to imported apparel products.

Background: the CNMI

The CNMI is a Commonwealth of the United States, located in the western part of the Pacific Ocean. The CNMI contains three main islands, Rota, Tinian and Saipan, and thirteen smaller islands comprising a total area of 183 square miles. The CNMI has a population of 49,000, about half of whom are native Chamorros, Carolinians or U.S. Mainland Americans. The remaining population consists of nonresident aliens who are primarily documented Asian workers.

After World War II, the Mariana Islands were placed under a United Nations trusteeship to be administered by the United States. In 1975, the Northern Mariana Islands voted for separate status as a United States Commonwealth, and after approval of a Constitution, became self-governing in 1978. In 1986, the CNMI was formally admitted as a U.S. Commonwealth and United States citizenship was conferred on the islands'

residents. The only major industries of the CNMI are tourism and garment manufacturing.

Background: The Proposed Rule Changes

The CNMI lauds U.S. efforts to develop non-preferential rules of origin which make origin determinations consistent, reliable, and transparent. However, we should take care that these new rules do not adversely impact industries who rely, in part, on manufacturing processes that were designed to conform to previous rules of origin.

Currently, United States Customs is developing final rules applicable to country of origin determinations for textile and apparel products. In addition to developing its own rules or origin applicable to U.S., the United States will also participate in World Trade Organization (WTO) negotiations to develop harmonized non-preferential rules of origin which would be applicable to all members of the WTO. Thus, CNMI exports of apparel products to the United States could be subject to two potentially disruptive changes in origin determination which could devastate the Commonwealth's garment industry.

Presently, rules of origin for textile and apparel products are contained in Section 12.130 of the Customs regulations (19 C.F.R. §12.130). This section embodies the "substantial transformation" rule which essentially provides that the country of origin of a product is the country where that product underwent a change in name, use, or character, such that it became a new

and different article of commerce. Under that section, cutting of fabric into parts constitutes a substantial transformation and, hence, confers origin.

The United States Customs Service proposed new rules for determining origin for textile and apparel products in a Federal Register notice published on May 23, 1995. 60 Fed. Reg. 27, 378. These new rules were required by Section 334 of the Uruguay Round Agreements Act. The proposed rules provide that such manufacturing processes as cutting, dyeing, and printing no longer confer origin. Instead, the rules state that the place of assembly is the place of origin. This difference is crucial to garment manufacturers who have set up cutting operations in particular locales in order to benefit from unfilled quota levels or preferential duty treatment. This difference is also crucial to economies, such as the CNMI, that rely in large part on their garment industries for industrial development, export earnings, and employment.

Headnote 3(a) and the Commonwealth Garment Industry

Most garment manufacturers in the CNMI established operations here in order to take advantage of preferential duty treatment. Under the Covenant to Establish a Commonwealth of the Northern Islands, the CNMI was accorded trading status equivalent to United States insular possessions. Therefore, imports to the United States from the CNMI are entitled to preferential duty status under General Headnote 3(a)(iv) of the Harmonized Tariff schedule (HTS). Headnote 3(a)(iv) provides that articles which are the growth, product, or manufacture of an insular possession are entitled to duty-free treatment upon importation into the United States,

provided that the article does not contain foreign materials comprising more than 70 percent of the total value of the article. With respect to textile and apparel products, the headnote specifies that the foreign material must not comprise more than 50 percent of the total value of the article. All other imports from the insular possessions receive column 1 most-favored-nation treatment.

In sum, in order to receive duty-free treatment, imported textile articles must be the product of the CNMI and meet the 50 percent value-added requirement.

Previous Rulings of the Customs Service

The Customs Service has issued several rulings regarding the circumstances under which textile articles imported from insular possessions are entitled to duty-free treatment. These rulings have directly affected how the garment business is carried out in the CNMI.

Most garment manufacturers in the Commonwealth import bolts of cloth material for processing into finished garments. Once imported, the bolts of material are marked and cut into component parts of various shapes and sizes. The pieces are then assembled together, undergoing numerous sewing operations, including hemming, serging, top stitching, and cover stitching. The assembled pieces -- garments, now -- then undergo inspection, trimming, pressing, folding, and packaging before being directly shipped to the United States.

In referring to Customs regulations on origin for textile products, Customs has held that the operations of marking the imported fabric into pattern pieces, cutting the fabric into pieces of various sizes and shapes, and assembling the pieces together by means of numerous sewing operations, result in a substantial transformation of the foreign fabric. Accordingly, under current rules of origin, fabric that is imported into the CNMI which undergoes cutting and assembling is deemed to be a "product of" the CNMI.

This "product of" designation is absolutely vital to our local garment industry.

Although it is not entirely clear from the text, it would appear that these same processing and assembly operations would also confer CNMI origin under the Proposed Rules of Origin for textile products issued in connection with Section 334 of the Uruguay Round Agreements Act. What is not clear from the Proposed Rules, however, is how the value of the foreign fabric would be treated for meeting the 50 percent value-added requirement; i.e. whether those same processing operations would assign the value of the fabric to the cost of "foreign materials", or to the cost of the materials produced in the CNMI. In a final interpretive rule, Customs has previously determined that the "double substantial transformation concept" is applicable in determining whether products meet the value requirement established under General Headnote 3(a). T.D. 88-17, 22 Cust. B, Dec. 128 (1988). In explaining their determination, Customs stated:

> Allowing the double substantial transformation concept to be applied means that the value of foreign material . . . may be considered as

> the value of material produced in the insular possession for the purpose of the 70 or 50 percent value determination if the foreign material is transformed in the insular possession through a substantial processing operation into a new and different product with a different name, character or use, and the new and different product is then transformed into yet another new and different product which is exported to the U.S.

In a subsequent ruling, Customs determined that the same processing operations mentioned above fulfilled the double substantial transformation requirement. First, Customs noted that it has consistently held that the cutting of fabric into specific or defined shapes for further assembly is sufficient to substantially transform the fabric into a new and different article of commerce. Thus, the first substantial transformation occurs when the fabric is cut into defined shapes and sizes. Customs went on to hold that the second substantial transformation occurs when the garment is assembled, inspected, trimmed, ironed, and packaged for shipment to the United States. Customs noted that the overall processing operations were substantial, and, therefore, constituted a second substantial transformation.

Our Problem with the Proposed Rules

As stated previously, it is not clear whether this double substantial transformation requirement would be met under the Proposed Rules issued by Customs. Arguably, the Proposed Rules only cover country of origin determinations, not foreign value determinations. However, under

current rules, country of origin determinations and foreign value determinations are made on the basis of the same standard -- the substantial transformation test. The Proposed Rules do not state whether the new rules of origin would also be applicable to foreign value determinations.

Whether this deficiency will be corrected in the Final Rules remains to be seen. Despite a statutory mandate to issue Final Rules by July 1, 1995, Customs has failed to do so, even though the new rules are to take effect on July 1, 1996, less than one year away. In the meantime, garment manufacturers in the CNMI are faced with additional uncertainty regarding the WTO rule-of-origin harmonization process and how that will affect operations in the CNMI.

From a business planning standpoint, garment manufacturers in the CNMI are crippled with uncertainty. This is an industry where orders are often made many months in advance. Many retailers will shortly place orders for final delivery of merchandise after July 1, 1996. However, these retailers will not know what the final rules of origin will be for their textile products, nor will they know what the duty treatment will be.

In order to avoid this uncertainty and in order to avoid lost sales from apparel no longer affordable to consumers, garment manufacturers may ultimately be forced to set up operations elsewhere. Such a result would be tragic and self-defeating both for CNMI development and for United States foreign policy.

The Worst-Case Scenario

It is easily conceivable that an unclear or negative country-of-origin rule could lead to the swift shutdown of our local garment industry. In the great scheme of world trade, this event would go unnoticed. Here in our islands, though, it would lead to serious economic problems.

The garment industry is the largest manufacturing industry in the Marianas. In point of fact, it is very nearly the only manufacturing industry in the Marianas. Although the CNMI has built up a successful tourist industry in the last fifteen years, tourism by itself is dangerously unstable and is probably not sufficient to raise the islands up to a U.S. standard of living. The garment industry is the second largest industry after tourism, and it is essential to our economy at this time.

It is true that there are problems with this industry. The garment industry places heavy demands on our islands' infrastructure, which have still not been entirely resolved. In the past, there were serious problems with labor abuses in the garment industry. These problems have been greatly reduced in the last few years, but the issue is still one that concerns us. And in the long term, our rising minimum wage (now $2.75, but mandated to reach $4.25 within six years) and progressively more-stringent labor, zoning, and safety laws may make our garment factories uncompetitive.

But this outcome, if it ever did happen, would be the kind of gradual industry transfer that is a normal and expected part of the free market

system. Our problems with our garment factories are more or less normal. The sudden and total extinction of our second largest industry because of a change in regulations would not be.

We estimate that the exit of the garment industry from the CNMI would result in the prompt and permanent reduction of government revenues by ten to fifteen percent. In addition to the direct loss in tax revenue, we would suffer additional losses from the multiplier effect. Businesses serving the garment industry directly, such as airlines, construction, shipping, insurance, retail shops, apartment owners, and banks, would be particularly hard hit.

Because our community is so small, the multiplier effect is actually enhanced. If a large city loses the services of a bank, or of an airline, there are many others to pick up the slack. But our Commonwealth is only served by a relative handful of businesses. If a bank or airline stops serving us, we feel the loss much more proportionately. Additionally, it may be a long time indeed before another business moves in. The Mariana Islands are not yet a world-class investment destination.

At present, our administration is pursuing a policy of financial independence from the United States. If we lose our garment industry, and the income we derive from it, we would probably have to abandon that policy, and ask the U.S. Government to subsidize the resulting revenue shortfall. At a time when the federal budget is being cut, and outlays to the states and territiories are being reduced, Congress could, of course, refuse to appropriate more money to the CNMI directly. Nevertheless, the

U.S. Treasury would still feel the impact anyway, in increased demand on U.S. entitlement programs here.

Such an outcome is certainly not in keeping with the WTO Agreement on Rules of Origin which seeks to avoid rules of origin which are restrictive, distorting, or have disruptive effects on international trade.

Conclusion

The CNMI believes that Customs should modify the Proposed Rule so that it clearly continues to permit the treatment of cutting as a substantial transformation for purposes of calculating the value qualification under Headnote 3(a). In addition, we believe that Congress should authorize Customs deferral of the promulgation of new rules of origin for textile and apparel products until the WTO completes its work on the harmonization of global rules of origin. This deferral would enable foreign manufacturers additional time to adjust to the changes brought about by global rules of origin, and would allow the United States Government additional time to consider the potential impact of changes in the way the country of origin is determined for textile and apparel products.

Thank you.

Sincerely yours,

Jesus C. Borja

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July 21, 1995

VIA FEDERAL EXPRESS
U.S. House of Representatives
Committee of Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Attention: Phillip D. Mosely, Chief of Staff

Re: Comments Of Pillowtex Corporation In Response To A Hearing Concerning Rules Of Origin Promulgated By The Treasury Department

Dear Mr. Mosely:

These comments are submitted on behalf of Pillowtex Corporation of 4111 Mint Way, Dallas, Texas. On July 11, 1995, the Trade Subcommittee to the Committee of Ways and Means held a hearing on rules of origin promulgated by the Treasury Department. Mr. Charles Hansen, Chairman and Chief Executive Officer of Pillowtex, testified at this hearing concerning how these rules negatively impact domestic manufacturers and importers of down comforters.

1. Background Information

Pillowtex is the largest U.S. manufacturer of down comforters and the fourth largest U.S. manufacturer of home textile products. Home textile products include comforters, pillows, blankets, duvet covers, mattress pads and similar items. Pillowtex has constructed the largest down processing facility in North America in Dallas, Texas. This facility alone represents an investment of over $8,000,000. In addition to its down processing facility, Pillowtex has comforter production facilities in Chicago, Los Angeles, Hanover, Pennsylvania and Tunica, Mississippi. These facilities use down processed by Pillowtex' Dallas facility and comforter shells to manufacture down comforters. In total, Pillowtex has eleven production facilities in the United States.

As explained by Mr. Hansen during his testimony, one of the main components used in the manufacture of down comforters is "down-proof" fabric. There is an insufficient supply of down-proof fabric produced in the United States.[1] Thus, Pillowtex, and all other U.S. down comforter manufacturers, must rely on imported fabric or imported fabric comforter shells for use in their manufacturing operations. Currently, only three countries in the world produce commercial quantities of down-proof fabric -- China, India and Germany. Down-proof fabric woven in China and India is subject to quota restrictions. Comforter shells constructed from this fabric are also subject to quota restrictions. The quota restrictions currently applicable to comforter shells are those negotiated between the United States and the country where the shell is cut and assembled from down-proof fabric.

The other main component used in the manufacture of down comforters is, of course, down. The process of refining down from feathers is complex and expensive. The feathers from which the down is refined must be washed, sorted, cleaned and separated. Due to the fragile nature of down and feathers, specialty equipment is required for these processing operations. As indicated above, Pillowtex has invested over $8,000,000 to construct its U.S. down processing facility.

2. History And Purpose Of Origin Determinations

The requirement that imported merchandise be marked with its country of origin can be traced to the Tariff Act of 1890. This requirement extends beyond the mere marking of goods. Origin determinations govern whether a product should be assessed with duties at the most-favored-nation rate or the higher rates set forth in Column 2 of the Tariff Schedules of the United States; whether a product, such as steel, is subject to voluntary restraint agreements negotiated between the United States and certain foreign governments, and whether textile products are subject to bilateral

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[1] *During his testimony before the Trade Subcommittee, Carlos Moore, Executive Vice President of the American Textile Manufacturers Institute, acknowledged that down-proof fabric is not produced in commercial quantities in the United States.*

restraint agreements negotiated by the United States pursuant to the Multifiber Arrangement.[2]

Since 1908, the "substantial transformation" test has been used to determine whether a product produced in more than one country has undergone a change in origin. This test is credited to the Supreme Court's decision in Anheuser-Busch Brewing Association v. United States, 207 U.S. 556 (1908), wherein the Court stated that:

> Manufacture implies a change, but every change is not manufacture . . . There must be a transformation; a new and different article must emerge having a distinctive name, character or use.

207 U.S. at 562.

Based on this test, the Court found that imported corks used to bottle beer did not undergo a substantial transformation in the United States when they were subjected to grading, washing, drying and a bath of glycerin and alcohol. The courts continue to apply this test.[3]

There are two important concepts to keep in mind when considering this test. First, the test focuses on whether a new article of commerce has been created, not what is the "most

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[2] *In Coastal States Marketing, Inc. v. United States, 10 CIT 613, aff'd 5 Fed. Cir. 103 (1987), the court held that Russian fuel oil did not undergo a substantial transformation when it was blended in a tanker with Italian fuel oil possessing slightly different properties. Accordingly, the Russian fuel oil was subjected to the higher Column 2 duties. In Ferrostaal Metals Corporation v. United States, 11 CIT 470 (1987), the court held that the process of galvanizing cold-rolled steel resulted in a substantial transformation, because galvanized steel possesses different physical properties and uses than cold-rolled steel. The cold-rolled steel was manufactured in Japan and the galvanizing process occurred in New Zealand. Because a substantial transformation occurred in New Zealand, the imported steel was not subject to the voluntary restraint agreement governing Japanese steel products exported to the United States. In Cardinal Glove Co. v. United States, 4 CIT 41 (1982), the court held that cotton gloves, assembled in Haiti from panels manufactured in Hong Kong, were products of Haiti, not Hong Kong, for quota restriction purposes.*

[3] *See, e.g., Koru North America v. United States, 12 CIT 1120 (1988).*

important" operation in the creation of the article.[4] Second, the test is flexible in nature and is not restricted to changes based on tariff classification. Indeed, the courts have specifically rejected substantial transformation tests based solely on changes in tariff classification, because tariff schedules are written for an entirely different reason -- the collection of duties -- not origin determinations.[5]

The problem of relying on tariff shift principles can be underscored by the following example. Comforter shells are classified under subheading 6307.90, HTS. As indicated above, these shells are constructed from specially woven cotton fabric with a high thread count. The proposed rule of origin for comforter shells provides that comforter shells are products of the country where the fabric was woven. If a company located in Country B could transform inexpensive rayon cloth woven in Country A into cotton cloth suitable for use in the production of comforters, everyone would agree that a substantial transformation had occurred. However, under Treasury's proposed rule, the comforter shell would be considered to be a product of Country A, because it did not undergo the requisite tariff shift. The miraculous transformation that occurred in Country B would be completely disregarded in determining the origin of this product.

3. Rules Of Origin Applicable To Textile Products

As indicated in footnote 2, the court in Cardinal Glove held that Hong Kong origin glove panels underwent a substantial transformation when they were assembled into finished gloves in Haiti. Two years after this decision, the Committee for the Implementation of Textile Agreements ("CITA") -- which is composed of representatives of the Department of Commerce, Treasury, State and Labor -- directed Treasury to promulgate rules of origin governing textile products in accordance

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[4] *For example, a person could conclude that the "most important" operation in the manufacture of a silk dress is preformed by silk worms that produce silk fibers. Silk worms are raised primarily in China and Japan. No one is suggesting that a silk dress made in France must be marked as a product of China or Japan.*

[5] *See, Roland Freres, Inc. v. United States, 23 CCPA 81 (1935), wherein the Court of Customs and Patent Appeals stated: "While the fact that by a manufacturing effort expended on an article its tariff status may have been changed is a proper matter to consider along with other circumstances in arriving at a conclusion as to whether the article has been manufactured or produced, it certainly should not be a controlling consideration." 23 CCPA at 83.*

with CITA's guidelines.

Treasury complied and, on August 3, 1984, it promulgated interim regulations governing the origin of textile products (49 Fed. Reg. 31,248). In this notice, Treasury stated that these rules were necessary because the future administration of textile agreements were severely jeopardized by the decision in Cardinal Glove. These regulations, which are set forth in 19 C.F.R. §12.130, provide that the origin of made-up articles shall be the country where fabric is cut into component parts and assembled into a completed article of commerce. 19 C.F.R. §12.130(e)(1)(iv). These regulations further provide that the assembly of all cut pieces of apparel articles shall effect a change in origin. 19 C.F.R. §12.130(e)(i)(v). The assembly of products other than apparel from cut components is governed by a number of factors, such as the physical change in the merchandise. Treasury has relied on these regulations to reach a result contrary to that in Cardinal Glove.[6]

Eleven years after these regulations were promulgated, the manner in which the origin of textile products and apparel is determined is being changed again. Pillowtex does not believe that constant changes to these laws is in the best interests of U.S. companies that must rely on the stability of these laws when planning production operations and sourcing decisions.

4. Existing Rules Of Origin Applicable To Down Comforters And Comforter Shells.

Currently, Treasury considers that the origin of down comforters is conferred by the process of filling the fabric comforter shell with down. This position is consistent with the substantial transformation test, because a comforter shell alone is incapable of providing warmth and down, by itself, is not a suitable bedding product. It is the combination of these in-put materials which result in a new and different article of commerce known as a down comforter.

Treasury has not uniformly applied this position. In December of 1994, Treasury issued a country of origin ruling holding that the origin of comforters would be governed by the country where the shell was constructed. A contrary decision was issued just four months later. Treasury neither referred to, nor revoked, its prior inconsistent decision despite the fact that Section 625 of Title VI (Customs Modernization Act) of the NAFTA Implementation Act (Pub. L. 103-182)

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[6] *See, Customs Service Decision 90-20.*

specifically requires Treasury to publish a notice of the revocation or modification of a prior decision. Treasury's failure to follow this procedure has resulted in confusion in the proper labeling of down comforters produced in the United States. More importantly, however, Treasury's failure to follow this procedure may have caused importers to obtain a visa from an improper foreign government.[7]

Treasury has also held that the origin of fabric comforter shells is the country where the shell is constructed (cut and sewn) from fabric. This position is consistent with the substantial transformation test, because a comforter shell is a different article of commerce than the fabric from which it is produced. In addition, this decision is consistent with 19 C.F.R. §12.130(e)(1)(iv).

5. Treasury's Proposed Origin Rules For Down Comforters And Comforter Shells.

The proposed rules of origin promulgated by Treasury in accordance with the Uruguay Round Agreements Act ("URAA") reverse both of the positions described in the preceding section. The proposed rules state that the origin of down comforters and comforter shells shall be the country where the fabric is woven. Treasury proposes to apply these rules to processing operations that occur in the United States.[8] The anticipated effect of the implementation of these rules is readily apparent. Down comforters manufactured in the United States from imported fabric or imported comforter shells will not be considered products of the United States. Rather, they must be marked as products China, India or Germany.[9]

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[7] *Clearly, the two decisions are conflicting. If an importer was only aware only of the first decision, it would conclude that a down comforter produced in Hong Kong from Chinese-origin shells would require a Chinese visa, as opposed to a Hong Kong visa, in order to enter into the commerce of the United States.*

[8] *The Uruguay Round Agreement contains an Agreement on Rules of Origin. Paragraphs (d) and (e) to Article 2 of the Origin Agreement require Members implementing rules of origin to apply them in a non-discriminatory, uniform and impartial manner. In connection with its proposed tariff shift rules promulgated pursuant to Annex 311 of NAFTA, Treasury has proposed to revise 19 C.F.R. §134.35 such that the tariff shift origin rules shall govern processing operations performed in the United States.*

[9] *The law requires that when imported merchandise is subjected to processing operations in the United States that do not amount to a substantial transformation, the resulting article will be marked with the origin of the imported merchandise. N.J.P.A. v. United States, 10 CIT 48 (1986).*

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In the preamble to its proposed rules of origin published pursuant to the URAA, Treasury indicated that the fabric forward rule of origin for down comforters and comforter shells was required by Section 334(b)(2)(A) of the URAA. This provision states that:

> The origin of a good that is classified under one of the following HTS headings or subheadings shall be determined under subparagraph (A), (B) or (C) of paragraph (1), as appropriate: 5609,5807,6209.20.50.40, 6213,6214, 6301, 6302, 6303, 6304, 6305, 6306, 6307.10, 6307.90, 6308 or 9404.90.[10]

Subparagraph (A) refers to products wholly obtained or produced in a single country. Subparagraph (B) provides for yarn, thread, twine, cordage, rope, cable or braiding, and subparagraph (C) provides for fabric. According to Treasury, this rule requires the "common sense" approach that products classified in the enumerated tariff provisions shall be considered to be products of the country where the fabric was formed.

Pillowtex submits that this interpretation is not based on "common sense." Rather, it is a mechanical rule divorced from commercial reality and inconsistent with the substantial transformation test. Pillowtex believes that, by including the words "as appropriate" in the statute, Congress intended Treasury to apply Section 334(b)(2)(A) only when application of this rule is appropriate. That is to say, if the product is a made-up article (such as a comforter and a comforter shell), then the multi-country rule should govern origin determinations. Application of the multi-country rule to these products will result in the conclusion that comforters are products of the country where they are blown and filled, and that comforter shells are products of the country where the fabric is cut into component pieces and assembled into finished shells.

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[10] *Down comforters are classified under subheading 9404.90, HTS. Fabric comforter shells are classified under subheading 6307.90, HTS.*

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6. Impact Of The Proposed Rules To Companies That Produce And Import Down Comforters

During his testimony, Mr. Hansen explained that the proposed rule of origin for down comforters would negatively affect Pillowtex. United States workers that are providing substantial value to the finished comforters would be required to sew labels onto the comforters that they manufacture, which state that the comforters are products of either China, India or Germany.

This rule will also negatively impact Pillowtex's export operations. As indicated above, the proposed rule would result in down comforters being considered products of the country where the fabric is woven. U.S. trading partners do not have similar rules. Both Canada and Mexico consider comforters produced in the United States from foreign-origin comforter shells to be products of the United States. At the time of production, Pillowtex does not know whether a particular comforter will be exported from the United States or sold domestically. Treasury's proposed rule would require that Pillowtex postpone labeling its products until they are designated to fill a specific order, or relabel products after production. Either solution will result in additional costs that will be passed onto consumers.

Of course, this assumes that comforters will continue to be produced in the United States. Comforters and comforter shells are subject to quota restrictions applicable to Quota Category 362. This quota category encompasses other products such as duvet covers. Competition for Category 362 quota from China is fierce. The 1995 quota allotment for this category filled on March 1, 1995. It is natural to assume that the Chinese government will grant its allotment of this limited resource to companies that are providing the most value-added in China. Thus, comforter manufacturers, not comforter shell manufacturers, will receive the majority of this quota. This will substantially decrease the amount of comforter shells Pillowtex can import and use in its U.S. production operations.

Because the origin of the fabric will govern the origin of finished comforters, it will be more economical to import finished comforters rather than to produce these same products domestically. Simply stated, there is no reason to use U.S. labor to manufacture a product of China. Due to the increased competition for Category 362 quota, Pillowtex will be required to import as many comforters as possible in the beginning of the year before the quota category closes. Thus, Pillowtex will have to tie-up working capital to cover its anticipated orders, and this cost will be passed onto consumers. Once the category closes, Pillowtex will be forced to use higher priced Indian

and German comforter shells and these costs will be passed onto consumers.

7. Impact Of Proposed Rules Of Origin On Bilateral Treaties

The United States has entered into numerous bilateral treaties regarding the quantity of textile products that can be imported from specific countries. These treaties provide that a certain quantity of merchandise subject to specific quota categories may be shipped to the United States. In negotiating these treaties, both parties have relied on existing rules of origin which allow products such as comforters, comforter shells and other bedding products to become products of a country other than the country where the fabric was woven, provided that specific operations are performed there.

Many countries that do not have sufficient weaving capacity have been granted specific limits of Category 362 quota. Treasury's proposed rules of origin will effectively negate such quota allotment, because Category 362 products produced in these countries will no longer be considered products of those countries. In renegotiating their bilateral treaties, these countries will demand increases in other categories (presumably wearing apparel so that companies prefroming assembly operations can produce articles for exportation to the United States.) Moreover, there is no indication that countries with substantial weaving capacity will have their quota allotments for Category 362 will be increased. Treasury's proposed origin rules would result in the nullification and impairment of bilateral treaties, and will cause substantial disruption to the flow of imports of products covered by this quota category into the United States.[11]

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[11] *In response to the proposed URAA rules of origin, the Canadian Embassy, the British Embassy, the European Union and several manufacturers of bedding products in Hong Kong submitted comments to Treasury, which outlined not only this problem but the fact that these proposed rules of origin radically depart from current U.S. and EC practices.*

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8. Section 334(b)(2)(A) Should Be Amended. Alternatively, The Effective Date Of The Proposed Regulations Should Be Postponed.

For the reasons set forth above, Pillowtex does not believe that the origin of bedding products should be governed by the origin of the fabric. Unless Congress intervenes, Treasury will implement its proposed regulations. Accordingly, Pillowtex requests that Congress remove subheadings 6307.90 and 9404.90, HTS from Section 334(b)(2)(A) of the URAA. Deletion of these two provisions will result in both comforters and comforter covers to be subject to the multi-country rule of origin.

In the event that Congress intends to allow these regulations to become effective, then their effective date should be postponed. Section 334 of URAA requires Treasury to promulgate final textile origin regulations by July 1, 1995. Congress specified that the effective date of these regulations shall be July 1, 1996. The year-long period between the promulgation of final regulations and their effective date was designed to enable companies to restructure their importing practices so as to minimize the impact of these changes. July 1, 1995 has come and gone. As of today, Treasury still has not published its final regulations. Pillowtex asks Congress to preserve the one-year grace period it established. Pillowtex is fearful that, unless this grace period is preserved, it will not have sufficient time to ensure that its production orders will be met.

NEVILLE, PETERSON & WILLIAMS

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9. Conclusion

The proposed rule of origin for down comforters and comforter shells is detrimental to U.S. down comforter manufacturers and U.S. consumers. It will increase prices, hamper exports, and result in the loss of U.S. jobs. The proposed rule is inconsistent with existing law and violates the substantial transformation test. Worse yet, no U.S. company will benefit from this rule because there are no U.S. producers of down-proof fabric. For these reasons, Pillowtex requests that Congress rectify this problem in the technical correction bill to the URAA.

Pillowtex welcomes the opportunity to present any additional information that Congress may require in order to resolve this issue.

Very truly yours,

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TESTIMONY SUBMITTED BY DR. HERMAN STAROBIN AND ARTHUR GUNDERSHEIM
CO-DIRECTORS, INTERNATIONAL TRADE DEPARTMENT,
UNION OF NEEDLETRADES, INDUSTRIAL AND TEXTILE EMPLOYEES (UNITE)

This testimony on Rules of Origin is presented in behalf of the 355,000 members of the Union of Needletrades, Industrial and Textile Employees (UNITE). UNITE came into being on July 1, 1995 with the merger of the International Ladies' Garment Workers' Union, founded in 1900, and the Amalgamated Clothing and Textile Workers Union, founded in 1914. Our members produce men's and women's apparel and accessories and textile and other industrial products in the fifty states and Puerto Rico.

Jobs and job opportunities in the industries we serve have been severely impacted by apparel and textile imports. This problem has been exacerbated by policies followed in recent years by successive Administrations. Apart from overall trade policies, which have adversely affected employment in manufacturing, we have been specifically subjected to such domestic job-losing trade agreements as the North American Free Trade Agreement and the Caribbean Basin Initiative. Even further inroads on domestic jobs in our industries are anticipated if Congress grants parity with Mexico to the CBI countries and as the Uruguay Round which created the World Trade Organization takes hold.

The rules of origin provision in the Uruguay Round agreement is the subject of the Committee's hearing. Other provisions in the agreement phase out all import quotas over a ten- year period beginning January 1, 1995. They also provide for growth-on-growth on existing quotas, which will hasten the increase of apparel and textile imports and the decline in industry jobs. Proper origin rules can help to prevent unfair avoidance of import quotas and slow the destruction of the domestic industries and its jobs.

In our submissions to U. S. Customs in response to the Federal Register notice of May 23, 1995 (60FR27378ff) requesting comments on Customs' proposed regulations on country rules of origin, we urged Customs to make its proposed regulations final. We pointed out that the proposed regulations conform to and properly implement Section 334 of the Uruguay Round Agreements Act and that modifications to the current rules of origin are appropriate in the light of industry practice and economics. We observed that the proposed rules eliminate inequities created by the previous rules.

The proposed rules are transparent and more predictable than the old ones. They will reduce or possibly even eliminate some of the distortions in textile and apparel trade. They are based on a consensus on methodology for determining origin that is used by all other industrial countries, a subject about which we will have more to say later in this testimony. They reflect commercial realities far better than the old rules.

Most important, the proposed rules eliminate the possibility of ambiguities in the future. Customs will not have to engage in lengthy, time consuming and expensive issuance of separate rulings, which confuse, rather than clarify, how imports are treated.

The new rules do not create a new trade barrier. On the contrary, they prevent continued use of a loophole by some exporters to the U. S. They are based on the dominant current practice in which most apparel imports originate in a single country. They follow the procedure used with respect to garments entering the U. S. under tariff heading 9802, where origin is conveyed by where the fabric pieces cut in the U. S. are assembled.

The rule proposed by Customs would underline this practice. It would recognize that assessing origin on where fabric is cut, rather than where it is assembled, would give exporters an advantage that bears no relation to the manufacturing process.

Under the current rule, such countries as Hong Kong and Singapore

are permitted to claim origin by cutting fabric for assembly elsewhere. They can use unused quotas by having assembly done in China and still maintain Hong Kong or Singapore origin. Hong Kong and Singapore would keep their quotas under the new rule. These quotas would grow in each year of the ten-year phaseout of existing textile/apparel agreements. However, they would have to assemble their own garments instead of using the China scam.

As far as made-up textile products are concerned (Chapter 63 of the Harmonized Tariff System), sewing operations require simple stitching and use very little labor, whereas in apparel, assembly represents 95 percent of the labor involved in making the product. The largest amount of labor involved in producing made-up goods goes into creating the fabric. Assembly labor on average is less than 25 percent of the overall labor expenditure in the final product. Origin should, therefore, be conveyed by where the fabric is formed. The Uruguay Round Agreements Act explicitly provides for such origin determination in Section 334, paragraph (2)(A).

The rules of origin proposed by Customs conform to the Uruguay Round enabling legislation. The Administration and the Congress jointly agreed to modify the existing definition of country of origin for textile and apparel products. Agreed-upon principles are contained in Section 334 of the Uruguay Round Agreements Act (P.L.103-465).

In the case of apparel, Section 334 determines origin of apparel products as follows:

* If a product is wholly produced in a single country, that country is the country of origin.

* If a product is wholly assembled in a country from components cut elsewhere, the country of assembly is the country of origin.

* If a product is knit to shape, the country where the knitting took place is the country of origin.

* If a product is assembled in more than one country, the country of origin is the one in which the most important assembly or manufacturing process occurs or if not conclusive (e.g., two countries perform equal amounts of assembly), the country in which the last <u>important</u> assembly or manufacturing occurs.

* In the case of made-up goods, Section 334, paragraph (2)(A) provides that origin of such products shall be the country in which the fabric used in such products is formed.

P. L. 103-465 provides that Customs issue regulations implementing the origin provisions of Section 334. Customs has accurately and fairly implemented the statutory provisions, taking into account necessary and technical details. The proposed regulations incorporate the statutory language. They not only conform to the relevant law, but also make eminent good sense in the light of industry operations and the nature of foreign sourcing.

From the standpoint of the production process, there is little reason to divide the manufacture of a garment between two or more countries. The practice of doing so, and the efforts to continue this practice, does not result from a search for new methods and improved efficiency. Rather, such convoluted sourcing patterns reflect attempts to secure the lowest possible labor costs, while minimizing duty and avoiding import quotas.

These goals are not necessarily illegal. However, they further the destruction of the jobs of American workers. Our nation's foreign trade laws and regulations should not be written to encourage such an obvious destructive practice.

The current Customs rule that confers origin on the country of cutting, except for "tailored" garments, contributed to unsound and evasive practices and had to be discontinued. In "cut-and-sew" apparel, the cutting of the fabric into garment parts constitutes a very minor five to seven percent of the labor required to make a garment. The overwhelming share of productive time goes into the assembly of the garment.

Any origin rule based on cutting thus creates the potential for locating cutting facilities any place in the world solely for the purpose of conferring origin and has little, if anything, to do with actual manufacturing need. Such activity contradicts reality.

U. S. garment importers have been taking advantage of these improper rules to cut garments in countries where wages are relatively high solely in order to take advantage of duty and quota privileges. Actual assembly, requiring the major use of labor, is then done in lower wage countries. Production platforms can be next door or across the globe.

Such practices result in the elimination of U. S. jobs and reduce government income from tariffs. They also mislead the consumer into believing that the garments have been made in countries where decent labor standards may be practiced. There is no way for the consumer to know that a garment labelled "Made in Hong Kong" or "Made in Singapore" was in fact manufactured in a low-wage country such as China, which denies workers' rights, encourages child labor and permits the most egregious violations of the environment.

The regulations proposed by Customs and mandated under the Uruguay Round implementing legislation do not tell any importer where to source garments. Since they would not go into effect until July 1, 1996, importers will have more than ample time to resolve any sourcing difficulties they may claim to have.

The proposed regulations insure that a garment will be labelled and charged to the country where the major amount of work has been done. Under this very logical concept, in the case of garments made of cut fabric parts as we have observed in the case of Item 9802 assembly, origin is defined as the country of assembly. In the case of garments knit-to-shape, the country of origin is the country where the knitting was done, no change from the present rule. The country of origin of made-up goods is logically the country where the fabric is produced.

To restate our conclusion: the proposed origin rules conform with the requirements of the Uruguay Round implementing legislation. They would also follow the practice of the other industrial nations as far as textiles and apparel are concerned. This would address your concern, Mr. Chairman, about harmonizing global rules of origin among WTO members and insure that the U. S. will have "a coherent position in the WTO discussions [on the work program to harmonize rules of origin] which reflects the interests of U. S. businesses." It would also reflect the interests of U. S. workers.

Mr. Chairman, UNITE supports the draft regulations on the rules of origin. We have urged their final adoption by the Customs Service. We ask the Congress to maintain the origin rules provided for in the Uruguay Round implementing legislation, which are embodied in the Customs proposed regulations.

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ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) AGREEMENT ON SHIPBUILDING

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JULY 18, 1995

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ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) AGREEMENT ON SHIPBUILDING

TUESDAY, JULY 18, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room 1100, Longworth House Office Building, Hon. Philip M. Crane (chairman of the subcommittee) presiding.

The press release announcing the hearing follows:

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
June 28, 1995
No. TR-14

CONTACT: (202) 225-1721

Crane Announces Hearing on the Organization for Economic Cooperation and Development Agreement on Shipbuilding

Congressman Philip M. Crane (R-IL), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the Organization for Economic Cooperation and Development (OECD) Shipbuilding Agreement. **The hearing will take place on Tuesday, July 18, 1995, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

BACKGROUND:

After five years of negotiation, key shipbuilding nations (the United States, the European Union, Japan, South Korea, Finland, Sweden, and Norway) completed negotiations and signed on December 21, 1994 the Agreement Respecting Normal Competitiveness Conditions in the Commercial Shipbuilding and Repair Industry. The Agreement, negotiated under the auspices of the OECD, applies to the construction and repair of self-propelled seagoing vessels of 100 gross tons and above and covers approximately 80 percent of the ships engaged in global shipping. The Agreement is scheduled to enter into force on January 1, 1996. In the interim, the signatories are in the process of formal ratification. In the United States, legislation must be enacted by Congress to bring U.S. law into compliance with the Agreement.

The U.S. negotiators have stated that the Agreement eliminates virtually all subsidies granted either directly to shipbuilders or indirectly through ship operators. In addition, the Agreement contains an injurious pricing code to prevent dumping in the shipbuilding industry. The Agreement includes a comprehensive discipline in government financing for exports and domestic ship sales as well as a dispute settlement mechanism.

In announcing the hearing, Chairman Crane stated: "I believe that this Agreement will open up trade in shipbuilding by eliminating distortive government subsidies and providing a remedy against injurious pricing practices. The Agreement should help achieve an international environment that gives the U.S. shipbuilding industry the best chance to compete in world markets that are not distorted through subsidization. I look forward to examining issues related to U.S. implementation of the Agreement."

FOCUS OF THE HEARING:

The focus of the hearing is to examine the issues within the Committee's jurisdiction related to U.S. implementation of the OECD Shipbuilding Agreement.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Monday, July 10, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Trade will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-6649.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Trade office, room 1104 Longworth House Office Building, no later than 10:00 a.m., Friday, July 14, 1995.** Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Tuesday, August 1, 1995 to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Trade office, room 1104 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available over the Internet at GOPHER.HOUSE.GOV, under 'HOUSE COMMITTEE INFORMATION'.

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Chairman CRANE. If everybody will take seats, we will commence.

Good morning, and welcome to this hearing of the Subcommittee on Trade concerning implementation of the OECD Shipbuilding Agreement. After 5 years of negotiation, key shipbuilding nations completed negotiations and signed on December 21, 1994, an agreement with respect to normal competitiveness conditions in the commercial shipbuilding and repair industry.

The Agreement, negotiated under the auspices of the OECD, applies to the construction and repair of self-propelled seagoing vessels of 100 gross tons and above and covers approximately 80 percent of the ships engaged in global shipping. The Agreement is scheduled to enter into force on January 1, 1996. In the interim, the signatories are in the process of formal ratification.

In the United States, legislation must be enacted by Congress to bring U.S. law into compliance with the Agreement. The U.S. negotiators have stated that the Agreement eliminates virtually all subsidies granted, either directly to shipbuilders or indirectly through ship operators. In addition, the Agreement contains an injurious pricing code to prevent dumping in the shipbuilding industry. The Agreement includes a comprehensive discipline in government financing for exports and domestic ship sales, as well as a disputes settlement mechanism.

I believe that this Agreement will open up trade in shipbuilding by eliminating distortive government subsidies and providing a remedy against injurious pricing practices. The Agreement should help achieve an international environment that gives the shipbuilding industry the best chance to compete in world markets that are not distorted through subsidization. Of course, any international agreement must be fair and balanced, and I seek assurances from our negotiators that the Agreement is truly symmetrical and that no special deals were cut to the detriment of the U.S. shipping industry.

I hope to introduce implementing legislation very shortly, to be cosponsored with my colleague Mr. Gibbons, who will be our first witness. Then I expect the subcommittee to mark up the legislation as soon as possible, if we are able, before our August recess. After that time, the full committee will take it up and then it will move to any other committees of jurisdiction.

Now I would like to recognize Mr. Coyne, if you have any opening comments. If not, today we will hear from a number of distinguished witnesses. In the interest of time, we always ask that witnesses keep their oral testimony to 5 minutes and, of course, any further written statements will be made a part of the record.

[Opening statement of Mr. Rangel follows:]

STATEMENT OF
THE HONORABLE CHARLES B. RANGEL
RANKING DEMOCRAT, SUBCOMMITTEE ON TRADE
HEARING ON THE
OECD SHIPBUILDING AGREEMENT
JULY 18, 1995

Thank you, Mr. Chairman, for holding today's hearing on the OECD Shipbuilding Agreement. This agreement is designed to eliminate shipbuilding subsidies and other trade distortive practices in the commercial shipbuilding industry in the key shipbuilding nations of the world. As I understand it, the agreement is scheduled to enter into force on January 1, 1996, assuming the signatories to the agreement, including the United States, have all completed their domestic ratification and implementation procedures by then. That means that the Congress will have to decide in the next several months whether to accept this agreement or to reject it. Thus, today's hearing is timely.

As is probably the case for many Members on the Subcommittee, I am not very familiar with the history behind this agreement or the details of the agreement itself. However, I do recall that Mr. Gibbons, our esteemed colleague, has been a major force in seeking the elimination of shipbuilding and other industrial subsidies around the world, and has worked on legislation in this area in the past. I look forward very much to his assessment of the agreement that has been negotiated. I also look forward to the testimony of Senator Breaux and the Members of the House who will offer testimony today, both in favor of and against the agreement.

It is clear at this point that this is a controversial agreement in the private sector. I appreciate that Chairman Crane has arranged to have two panels of witnesses from the private sector who represent both the proponents and the opponents of the agreement. I intend to listen carefully to the arguments they present today, both in favor of and against this agreement. I also intend to review carefully the Administration's presentation as to why this agreement serves well both the interests of the U.S. shipbuilding industry and our national economic interests.

Thank you, Mr. Chairman.

Chairman CRANE. Our first witness, as I indicated, is our distinguished colleague from Florida. Mr. Gibbons has long been a supporter of eliminating shipbuilding subsidies which distort international trade, and I look forward to introducing later this month the legislation I referred to earlier together with Mr. Gibbons to implement this Agreement.

Now I yield to our distinguished member of the Trade Subcommittee and also ranking minority member on the Ways and Means Committee, Mr. Gibbons.

STATEMENT OF HON. SAM M. GIBBONS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. GIBBONS. Thank you, Mr. Crane. At the outset of this hearing, I think all of us want to express to you publicly and privately our concern about the loss of your father. I know that you and I have discussed this and I know how terrible it is to lose a loved one like that. I just wanted to say that publicly.

Chairman CRANE. Thank you very kindly for that. I would simply mention, as I did to you earlier, that my dad turned 94 in April and passed away in his sleep, and that is the most merciful way to go. He had a long, full and productive life. Thank you.

Mr. GIBBONS. Yes, sir.

Mr. Chairman, I ask unanimous consent that my full statement be made a part of the record.

Chairman CRANE. Without objection, so ordered.

Mr. GIBBONS. Mr. Chairman, let me review briefly the history of this legislation and the need for it. Up until the Gramm-Latta substitute for the budget resolution in 1981, the United States had various subsidy programs of its own in the shipbuilding area. The Gramm-Latta substitute for the budget resolution wiped out all shipbuilding subsidies in the United States, and so the United States faced the shipbuilding world without any subsidies, and all the rest of the countries on Earth were subsidizing their shipbuilding.

For a while, this did not seriously impact the U.S. yards, because the U.S. yards were so busy with the large defense buildup. But that ran out, as all of us know, and now the U.S. yards are faced with a downturn, a tremendous downturn in employment and contracts for U.S. naval ships. Meanwhile, the rest of the world goes on subsidizing its commercial shipbuilding. Therefore, we have practically no commercial shipbuilding going on in the United States. It is just not possible in most cases to get a contract, when a foreign yard and a foreign government can outsubsidize U.S. yards on the purchase price or can dump their ships on the world market, if they have built a surplus of them.

In the late eighties, I met with the people in the shipbuilding industry and told them that I would help them try to get rid of the international subsidies. It has been a long and tortuous process. The House of Representatives in early 1992 passed an antisubsidy bill, the Shipbuilding Reform Trade Act, but it went to the Senate where it did not finally pass.

A little later on in the nineties, this committee again acted, all the time keeping up the pressure that had been built on the USTR to negotiate this Agreement. The USTR chose to negotiate the

Agreement in the OECD, rather than in the GATT, because of the expertise that existed in the OECD on this particular subject.

About a year ago, maybe a year and a half ago, the negotiators finally, after long, tortuous and arduous negotiations, worked out an international agreement. When you look at it from a trade point of view, it is the best agreement we have ever entered into as far as trade law is concerned. It absolutely does away eventually with government subsidy of commercial shipbuilding. It absolutely outlaws the dumping of foreign-made ships on the ship market at less than the cost that it took to build them. It has restraints on the amount of government financing that can be done in the purchase of these ships.

As I say, I have looked over trade agreements for more than 20 years now and this is the best trade agreement I have ever seen. It is the most complete, the most thorough, the most detailed, and it has within it a dispute settlement mechanism that will work to put an end to these injurious subsidy practices and dumping practices in shipbuilding.

For a long time, I thought that the shipbuilding industry was totally united behind this program. But some yards, essentially those yards that are largely dependent upon U.S. naval construction, have decided that we ought to get a better agreement. Frankly, I do not know how you get a better agreement

It took a reluctant world over 5 years to reach this Agreement. We have no leverage, because we have no subsidy program except the title XI loan guarantee program, and the title XI program is a program that would last about the length of time it would take you to snap your fingers, if we should turn this Agreement down, because every other country on Earth would match or better title XI.

Under the Agreement, we agreed to have a standstill on subsidies until the Agreement enters into effect on January 1, 1996, and the title XI program got its nose under the tent just before the standstill took effect. But as soon as we signal to the rest of the world that we are not going to pass this Agreement, the rest of the world is going to come in and start subsidizing just like we do under title XI. Title XI is essentially a way to finance ship purchases. It is a generous program, probably more generous than this Congress would enact today, and probably more generous than this Congress is willing to fund into the future.

So it is a feather in the breeze as far as subsidy is concerned and will last about that long, should we ever signal to the world that we are not going to agree to the Shipbuilding Agreement. Moreover, should the Congress decide, well, we got rid of shipbuilding subsidies once in Gramm-Latta, we got title XI in through the backdoor a year or so ago under the standstill agreement and we should keep it, our currently favorable situation would not last until the end of the year, if the word went out to the world that we are not going to ratify this Agreement.

I have a feeling that I have taken more time than I perhaps should in this introductory statement. Let me quickly summarize this by saying:

This Agreement virtually eliminates all subsidies granted either directly to shipbuilders or indirectly through ship operators. The

injurious pricing code designed to prevent dumping to the shipbuilding industry is in this Agreement. The comprehensive discipline on government financing for export of domestic ship sales designed to distort normal commercial trade in ships is included. And there is an effective binding disputes settlement mechanism that will guarantee that if disputes arise, and certainly they will arise, that we can get a quick agreement.

I have checked recently on the progress of this in the international field. It seems to me that all of the major shipbuilding countries are ready to ratify this. They are merely waiting for us to signal that we are going to do it, because, as you know, we have the most difficult ratification process in the whole world. If we would ratify this, as we should by the end of this year, all of the major problems in our shipbuilding industry as far as competitive practices are concerned should be solved.

There is something called the Jones Act that has been in existence for a long time. The Jones Act, in effect, protects American ships trading between American ports. This Agreement does not disturb the Jones Act. Only Congress acting can change the Jones Act, and the Jones Act builders and operators support this Agreement, as I understand it. So anybody who says we are destroying the Jones Act by this is just throwing you a red herring.

Mr. Chairman, that is all I have to say. Thank you very much. I will be glad to answer questions.

[The prepared statement follows:]

**TESTIMONY OF THE HONORABLE SAM M. GIBBONS,
RANKING DEMOCRAT, COMMITTEE ON WAYS AND MEANS,
BEFORE THE SUBCOMMITTEE ON TRADE ON
THE OECD AGREEMENT ON SHIPBUILDING
JULY 18, 1995**

Thank you, Mr. Chairman, for allowing me to testify today before the Subcommittee on Trade on the subject of the OECD Agreement on Shipbuilding. As you know, this is an issue on which I have spent considerable time in recent years. I look forward to working with you, Mr. Rangel, our Ranking Democrat on the Subcommittee, and the other Members of the Subcommittee, in developing and enacting legislation to implement this important agreement.

Before turning to the agreement itself, I would like to review briefly for the Subcommittee how we got to where we are today. This history is important so that we can put this agreement in its proper perspective.

A Brief Historical Perspective

On June 8, 1989, the Shipbuilders Council of America (SCA) filed a petition under section 301 of the Trade Act of 1974, seeking action by the U.S. Trade Representative (USTR) against the shipbuilding subsidies of Japan, South Korea, Germany, and Norway. The U.S. shipbuilding industry had seen the last of its subsidy programs terminated in 1981, and believed that it would be impossible to reenter the world commercial shipbuilding market unless their foreign competitors ceased receiving massive government assistance. The U.S. industry had virtually abandoned this market in the 1980s as it concentrated on building naval ships in response to the U.S. defense buildup. However, as the industry looked to the future in the late 1980s, it was becoming increasingly evident that defense budgets would shrink and U.S. shipbuilders would have to shift capacity to the commercial marketplace in order to survive.

After consultations between then-USTR Carla Hills and the SCA, it was agreed that the 301 petition would be withdrawn, without prejudice, while USTR pursued a multilateral agreement to end shipbuilding subsidies in the Organization for Economic Cooperation and Development (OECD) or the Uruguay Round of GATT negotiations. Unfortunately, but not surprisingly, progress was painfully slow in the OECD discussions because the United States lacked any real leverage in the negotiations. After all, the United States was asking the other shipbuilding nations to eliminate those types of subsidies that the United States had unilaterally terminated nearly a decade earlier.

Given the slow pace of the negotiations, I chaired a hearing of the Subcommittee on Trade on March 21, 1991, to review the status of the OECD negotiations and to explore available options to deal with the problem. After that hearing, I concluded that one option would be to pursue legislation that would provide, under U.S. law, unilateral trade remedies to U.S. shipbuilders against foreign subsidized commercial ships. In my view, absent an international agreement, such legislation was necessary due to the lack of adequate protection under U.S. antidumping and countervailing duty laws against unfair foreign trade practices. Traditional U.S. trade law lacked such protection because ships engaged in international commerce are not considered to be imported goods since they literally stop at water's edge and do not enter the United States as articles of commerce.

My legislation, known as the "Shipbuilding Trade Reform Act of 1991," was passed by the House of Representatives by a vote of 339-78 on May 13, 1992. However, the Senate failed to pass comparable legislation before the end of the 102nd Congress. Although my legislation failed to pass the 102nd Congress, it set off alarm bells in foreign capitals and succeeded in giving much needed impetus to the international negotiating process. Therefore, in order to keep the pressure on the international negotiators, I introduced the legislation again at the beginning of the 103rd Congress. The Subcommittee on Trade approved an amended

version of my "Shipbuilding Reform Act of 1993" on November 9, 1993. Fortunately, it was not necessary to move the legislation beyond this point because, by this time, the OECD talks had continued to gather momentum, which ultimately resulted in the agreement we are considering today.

The OECD Agreement

Later today, the Administration will describe the OECD agreement in some detail and will outline in general terms what needs to be accomplished legislatively to implement the agreement. Generally speaking, the agreement contains four major elements:

-- The elimination of virtually all subsidies granted either directly to shipbuilders or indirectly through ship operators.

-- An injurious pricing code designed to prevent dumping in the shipbuilding industry.

-- A comprehensive discipline on government financing for exports and domestic ship sales designed to avoid trade-distortive financing.

-- An effective, and binding, dispute settlement mechanism. Dispute settlement panels will be established as necessary in order to determine whether subsidy or other government measures are consistent with the agreement, and to ensure that the injurious pricing code is being properly implemented. Failure to comply with a panel's finding may result in the imposition of sanctions, i.e., the withdrawal of World Trade Organization (WTO)/General Agreement on Tariffs and Trade (GATT) concessions or the denial of off-loading privileges.

There are certain exceptions to the agreement's prohibition of subsidies and other distortive government practices:

-- Government support is permitted for worker retirement, severance, or retraining associated with the closure or downsizing of shipyards.

-- Government assistance for research and development is allowed under certain conditions, provided it is granted in accordance with the terms of the agreement.

-- Certain restructuring assistance programs for Belgium, Portugal, and Spain, intended to address the social cost of downsizing or closing shipyards, will be allowed to continue for a limited time after entry into force of the agreement.

-- The agreement exempts "build in U.S." requirements contained in the Jones Act and other U.S. coastwise (cabotage) maritime laws, a critical provision from the U.S. industry's perspective.

Why the OECD Agreement Should Be Approved

The OECD Shipbuilding Agreement successfully addresses the destructive pattern of heavy government subsidies and chronic predatory pricing that has long characterized the global commercial shipbuilding industry. It is the most far-reaching international agreement ever negotiated to deal with subsidies and other distortive trade practices in any commodity, service, or industry sector.

For example, with respect to subsidies, the agreement extends far beyond the subsidy rules of the WTO. It requires other countries to give up the substantial support to their shipyards, in return for modest changes in U.S. programs (as well as no changes in the Jones Act). For instance, the European Union (EU) will have to eliminate government grants to shipyards currently amounting to around 9 percent of contract value, as

well as equity infusions inconsistent with normal provision of risk capital.

The agreement establishes, for the first time in history, a strict mechanism for protecting the international shipbuilding market from dumping practices. As I noted previously, until this agreement, there has been no way to deal with predatory pricing since traditional antidumping law is not applicable to ships.

The agreement establishes a separate discipline governing government export credit and tied-aid programs much tougher than what exists today.

The binding enforcement mechanism against subsidies and dumping is tougher than what exists in the WTO or in other international agreements.

In sum, this agreement is in the best interest of the United States and should be approved and implemented by the United States Congress. The agreement has the support of a broad cross-section of economic interests in this country and I look forward to hearing their testimony today.

Responding to Criticisms of the Agreement

At the same time, I am deeply troubled by the fact that there are a number of shipyards in this country who have spoken out in opposition to this agreement. As I understand it, their opposition is based primarily on the fact that certain U.S. maritime programs must be modified to implement this agreement. While some changes to U.S. maritime law will indeed be required, I urge these shipyards to reconsider their position on the basis of one compelling factor. The OECD Shipbuilding Agreement is the best chance we have to create unsubsidized competition and equitable conditions of trade in the global commercial shipbuilding market.

If we reject this agreement, we will be right back where we started in 1989. Our trading partners will undoubtedly continue their subsidizing ways, will respond in kind to any favorable financing or other programs we might be able to provide under Title 11, and will continue to engage in predatory pricing practices with impunity. In today's budgetary climate, we will certainly continue to lose a subsidy war with our trading partners. Moreover, our ability to pursue other legislative options in Congress (such as my earlier legislation) for dealing with this issue, in the absence of the OECD Agreement, are, at best, uncertain. Finally, I am not persuaded that renegotiation of the agreement, as some are advocating, is a viable option. After all, this agreement took five years to conclude, and was the product of hard bargaining and concessions on all sides. We should be under no illusion that we can simply go back to the negotiating table and modify the agreement to allow those practices we want to keep, while prohibiting those of our trading partners that we want to eliminate.

Conclusion

The OECD Agreement on Shipbuilding, like every other trade agreement into which we have ever entered, is not a perfect instrument that achieves all the objectives of all who have an interest in it. However, it is a sound, balanced agreement that will substantially level the playing field for the U.S. shipbuilding industry in the international shipbuilding market for many years to come.

I look forward to working with my colleagues on this Subcommittee to implement this important agreement. I also intend to listen carefully to the concerns of those who currently oppose the agreement and to any realistic options they may propose to address any valid concerns raised during the course of our consideration of this agreement.

Chairman CRANE. We want to thank you, Mr. Gibbons, for your distinguished leadership on this issue and your endurance in seeing it through and, God willing, it will be consummated positively.

With that, I would like to yield to Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Thank you, Mr. Gibbons, for that very clear explanation. I would like to ask a question, though. If I understand, the concept here is to get rid of all subsidies.

Mr. GIBBONS. Yes.

Mr. HOUGHTON. Therefore, to have the so-called "level playingfield." But there are shipyards here, not only those who produce products for the Navy, but also others who oppose because they feel that the subsidies will not be lessened in other countries, while they would be eliminated here. Would you like to explain that?

Mr. GIBBONS. Well, they have already been eliminated here. We really do not have any domestic U.S. subsidy program except the so-called title XI program which was enacted just shortly before this Agreement was entered into. The title XI program is essentially a financing subsidy. It is not a direct building subsidy. We have not had any building subsidies in this country since 1981.

The rest of the world is bound and will ratify this Agreement, I believe, but they will not do it until after we have done it, which is a prudent way for the rest of the world to work, because we are the ones that pushed this Agreement, we are the ones who had the most to gain from this Agreement.

Other countries gain practically nothing compared to what the United States gets. We just have practically no commercial shipbuilding and have had no commercial shipbuilding on the international scale for years, despite the fact that labor costs in our commercial yards are competitive on a worldwide basis. But foreign governments have persisted in the subsidies that we unilaterally did away with in 1981.

Mr. HOUGHTON. Mr. Gibbons, if I understand it, let me just try to clarify in my own mind that if this legislation goes through, title XI goes and also all the other subsidies in other countries will go following this action of ours.

Mr. GIBBONS. Title XI terms and conditions will go back to the international standards of the Agreement. Title XI will thus be put on a commercially competitive basis. Title XI will not be completely destroyed. Title XI is a fig leaf. It will be lost in a general 5-knot breeze, if we do not accept this Agreement. The only reason title XI has worked is because of the timing of this Agreement.

Shortly before this Agreement was signed, Congress passed title XI. Nobody thought much about it. Nobody thought it would be very productive. But there was a standstill arrangement in this Agreement saying that countries would stand still as of the date the Agreement was signed, and title XI became effective for a couple of shipyards to do sales with favorable financing in that time.

Mr. HOUGHTON. But what about the other——

Mr. GIBBONS. But other countries, as soon as we signal that we are not going to ratify this Agreement, they will not be bound by the standstill arrangement that is in this Agreement that they have all signed, and they will just copy and probably outdo title XI.

They are caught in a little bind, but not enough of a bind that really worries them.

Mr. HOUGHTON. Let me move just very briefly—and then I will stop, Mr. Chairman—to the other issue of the subsidies in other foreign countries. So if we do pass this legislation and they will not be able to replicate title XI or whatever in their own laws, will some subsidies still be maintained in those countries?

Mr. GIBBONS. Generally, no. Of course, there are some transition rules in here. Some countries will be able to continue some of their subsidies to downsize their yards. These are mainly social subsidies for unemployment and for dislocations and things of that sort.

Mr. HOUGHTON. It will not have any impact on the product?

Mr. GIBBONS. No. Any time we enter into an agreement where we have got a very imperfect world to work in, there are going to have to be transition rules, and there are some very short-term transition rules in here, but they will be bound. And I have no doubt that this will be effective, or we can retaliate against them in the World Trade Organization or under the OECD auspices to make sure that they cease subsidies.

This is the best agreement, Mr. Houghton, I have ever seen for getting rid of subsidies. Nothing that this Congress has ever passed is as draconian and as effective as this is. I would hope that we could get the rest of the world to agree to the kind of antisubsidy provisions in the World Trade Organization that we have got in this. This is the best effort I have ever seen the world do and the United States do as far as getting rid of subsidies.

Mr. HOUGHTON. Thank you very much.

Chairman CRANE. Mr. Coyne.

Mr. COYNE. No questions.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. No questions.

Chairman CRANE. With that then, we will excuse you and ask you to come up here on the dais, Mr. Gibbons. Thank you for your testimony.

Mr. GIBBONS. Thank you.

Chairman CRANE. Our next witness is one of our colleagues from the Senate, Senator John Breaux from Louisiana. He, too, is a staunch supporter of the Agreement.

Mr. Breaux.

STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM THE STATE OF LOUISIANA

Senator BREAUX. Thank you very much, Mr. Chairman and members of the Ways and Means Committee. I am delighted to be able to come over and share some thoughts with you.

I just returned from the Senate Finance Committee which is having a hearing of our own. In comparing our hearing room, which I think looks like a scene from the Nuremberg war trials, to the hearing room here of the Ways and Means Committee, there is no comparison. You are doing very well.

But I am delighted to be here. I think that Sam Gibbons has given you a good overview and a perspective of what we are talking about here today, and it really is quite simple. Mr. Chairman, although there is disagreement among various aspects of the indus-

try the question is whether this OECD Agreement should be enacted by the Congress of the United States.

I know that shipbuilding in my State is incredibly important. We have about 27,000 employees that work in shipbuilding related jobs in Louisiana. This is a major industry in my State. We have shipyards who will be testifying before this committee this morning who have different opinions. Avondale Shipyard, one of our largest, will be represented by Al Bossier, its president, who is opposed to this Agreement. Trinity Marine, on the other hand, another major shipbuilder in the gulf, is going to be testifying in support of it. So we have a problem to decide what is best for this country.

But I think that the real question comes down in a nutshell as to whether we in the United States are going to enter into a subsidy battle with the rest of the world with regard to shipbuilding. Are we going to negotiate the best possible agreement to end worldwide subsidies, so we can compete on a level playingfield with our shipyards competing against other shipyards on an equal footing? This is really the essential question.

I do not think anyone on this committee or anyone over in the Senate thinks we are going to get into a subsidy battle and win. You and I are talking about $450 billion in Medicare and Medicaid cuts. Does anyone suggest that Congress is going to enter into a proposal to create subsidies for the shipbuilding industry of the United States, in light of those problems that we are facing? I would suggest the answer is very clear and it is "no."

So what we have to do is to move away from the subsidy concepts and toward what the shipyards were telling us we should do years ago; that is, to get an agreement that eliminates foreign subsidies so we can compete, and that is exactly what this Agreement does. Jeff Lang, who is our ambassador over this Agreement, will be presenting testimony which will outline essentially what this Agreement does. It is a good solid agreement. Is it perfect? Of course not. Nothing we do or nothing any international body is going to ever do is going to be perfect. But it is by far the best agreement possible.

In summary, what it does is eliminate unfair foreign subsidies and other distortive trade practices in the shipbuilding industry around the world. It allows the United States to continue with programs that are consistent with what other countries around the world have agreed to.

As Congressman Gibbons says, we will still keep title XI, which is a long-term loan to shipyards to build ships. We can do whatever we want with the program, as long as it is for domestic ships that operate here in this country under the Jones Act. But for international shipbuilding, we will have to comply with the terms of the OECD Agreement, that is, the terms for the loan guarantee will come down from 25 to 12 years. We will still have that program.

We used to have subsidies. When I was serving over here in the House with Congressman Gibbons and Congressman Crane, we had a construction differential subsidy program. CDS it was called, which actually subsidized U.S. shipyards to make up for the subsidies that the other countries had. When Ronald Reagan was elected, that was one of the first things that went out the window.

He eliminated construction differential subsidies. We were not going to subsidize our shipyards any more.

What happened? Our commercial shipyards then aggressively moved into building military defense ships. You all remember when we were talking about the 600-ship navy and a lot of Navy work was going into our commercial shipyards. We could not compete on commercial ships because we did not have a subsidy any more. Now that the Navy demand is coming down and defense ship construction is coming down, some of these same yards that were building defense vessels are now saying we want to get back into commercial construction, but we cannot do it without subsidies.

And that is what we are facing right now: Do we go back into the subsidy war? Is the Ways and Means Committee willing to pass a new tax to pay for subsidies for shipbuilding? Or are we going to look at accepting an agreement that took a long period of time to negotiate and that basically allows us to take the strongest action we have ever had the right to take against other countries that engage in unfair shipbuilding practices? We can take them immediately to a panel and deprive them of some of their GATT benefits. We have other things that Deputy USTR Jeff Lang will explain that we can do to countries that violate this Agreement. And we do not even have to show injury in subsidies cases.

In most of our trade agreements, in order to show unfair trade practices, not only do you have to show what they did was wrong, you have to show injury to the United States. You do not even have to do that in this Agreement, just show that it is a prohibited subsidy and we can take action to eliminate it.

Mr. Chairman and members of the committee, I think the choice is very, very clear. There will be some opposition saying, well, it affects our Jones Act ships. I think it does not. The companies that engage in the Jones Act trade, the largest Jones Act operators, Sealand and CSX, support this Agreement. The American waterways operators, which are the largest group of Jones Act vessels working the U.S. waters, rivers and lakes support this Agreement. The American Institute of Merchant Shipping, which operates Jones Act vessels, supports this Agreement.

So the people who would be adversely affected if the Agreement were to harm the Jones Act, support it. I guarantee you they would not support it, if they thought for 1 minute that it hurt the Jones Act trade.

Mr. Chairman and members, I think we have a good agreement. We are not going to enact subsidies. The Defense Department in a letter, which I will make part of the record, clearly says do not count on us to provide any subsidies to the commercial shipyards, forget it, we are going to build defense ships and we are not going to take defense dollars, which are being cut, in order to build commercial ships or to even subsidize the commercial shipbuilding industry.

This Agreement, in summary, Mr. Chairman, does exactly what the U.S. shipbuilding industry has said for years it wanted, eliminate foreign subsidies so we can compete. This Agreement does that. They can compete, and we should adopt this Agreement.

Thank you.

[The prepared statement and attachment follow:]

U.S. SENATOR JOHN BREAUX

HOUSE WAYS AND MEANS COMMITTEE
INTERNATIONAL TRADE SUBCOMMITTEE
JULY 18, 1995

STATEMENT IN SUPPORT OF O.E.C.D. SHIPBUILDING AGREEMENT

GOOD MORNING, MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. I'M PLEASED TO BE ABLE TO OFFER YOU MY COMMENTS IN SUPPORT OF THE O.E.C.D. SHIPBUILDING AGREEMENT. WHILE NOT A PERFECT AGREEMENT, IT APPEARS TO BE OUR LAST BEST CHANCE TO ELIMINATE UNFAIR SUBSIDIES, TO COUNTER INJURIOUS PRICING POLICIES, TO REIGN IN TRADE DISTORTING EXPORT FINANCING, AND TO INSTITUTE AN EFFECTIVE BINDING DISPUTE SETTLEMENT SYSTEM FOR SHIPBUILDING CONTROVERSIES. BECAUSE OF THIS AGREEMENT, FOR THE FIRST TIME, U.S. SHIPYARD WORKERS WILL HAVE SAFEGUARDS AGAINST HAVING TO COMPETE WITH CONTINUED FUNDING FROM FOREIGN TREASURIES.

MY INVOLVEMENT WITH THE ISSUE OF UNFAIR FOREIGN SHIPBUILDING PRACTICES RELATES TO MY STATE OF LOUISIANA BEING ONE OF THE PREMIER SHIPBUILDING STATES IN THE COUNTRY. OVER 27,000 LOUISIANA JOBS ARE IMPACTED BY CONSTRUCTING OR REPAIRING SHIPS. OUR LARGEST SHIPYARD, AVONDALE, IS REPRESENTED HERE TODAY BY ITS PRESIDENT, MR. AL BOSSIER, AS IS ANOTHER MAJOR LOUISIANA SHIPYARD EMPLOYER, TRINITY MARINE, REPRESENTED BY MR. HARVEY WALPERT.

AS HAS BEEN THE CASE NATIONWIDE, LOUISIANA'S SHIPBUILDING EMPLOYMENT HAS SUFFERED SIGNIFICANTLY SINCE THE 1980'S. THIS SITUATION IS DUE TO U.S. DEFENSE DOWNSIZING AND TO UNFAIR FOREIGN SHIPBUILDING PRACTICES. SINCE 1989, I'VE BEEN ACTIVELY WORKING TO ELIMINATE UNFAIR FOREIGN SHIPBUILDING PRACTICES AND TO RESTORE THE U.S. COMMERCIAL SHIPBUILDING INDUSTRY.

WHAT I WOULD LIKE TO DO TODAY IS TO SHARE WITH YOU SOME OF THE HISTORICAL CONTEXT THAT SURROUNDS THE AGREEMENT AND IMPLEMENTING LEGISLATION. THEN I'D LIKE TO ADDRESS WHAT I CONSIDER TO BE THE CENTRAL ISSUE BEFORE US AND EXPLAIN WHY I BELIEVE THE O.E.C.D. AGREEMENT IS THE BEST ALTERNATIVE FOR ADDRESSING THE DILEMMA FACING OUR SHIPBUILDERS TODAY.

FROM 1974 TO 1987, WORLD-WIDE OVERALL DEMAND FOR OCEAN GOING VESSELS DECLINED 71%. DURING THE SAME TIME SPAN, UNITED STATES MERCHANT VESSEL CONSTRUCTION DROPPED DRASTICALLY FROM AN AVERAGE OF 72 SHIPS/YEAR TO AN AVERAGE OF 21 SHIPS/YEAR. ALSO DURING THIS PERIOD GOVERNMENTS IN ALL THE MAJOR SHIPBUILDING NATIONS, WITH THE EXCEPTION OF THE UNITED STATES, DRAMATICALLY INCREASED AID TO THEIR SHIPYARDS AND THEIR ASSOCIATED INFRASTRUCTURE WITH MASSIVE LEVELS OF SUBSIDIES IN VIRTUALLY EVERY FORM.

THE U.S. GOVERNMENT, HOWEVER, UNDER PRESIDENT REAGAN DECIDED TO UNILATERALLY TERMINATE COMMERCIAL CONSTRUCTION

SUBSIDIES TO U.S. YARDS. INSTEAD, U.S. DEFENSE SHIPBUILDING INCREASED. U.S. DEFENSE SHIPBUILDING CONSTRUCTION ROSE FROM AN AVERAGE OF 79 SHIPS/YEAR IN THE 70'S TO AN AVERAGE OF 95 SHIPS/YEAR IN THE 80'S. THE NET RESULT WAS A VIRTUAL ABANDONMENT BY THE LARGE U.S. DEFENSE YARDS OF THE INTERNATIONAL COMMERCIAL SHIPBUILDING MARKET TO SUBSIDIZED FOREIGN YARDS. IN TEN YEARS, THE NUMBER OF MAJOR U.S. SHIPYARDS PRODUCING ONLY COMMERCIAL SHIPS DECLINED FROM ELEVEN TO ONE.

THE END OF THE 1980'S SAW A DEPARTMENT OF DEFENSE REEVALUATION OF THE NEED FOR A 600 SHIP NAVY. IT ALSO SAW THE U.S. SHIPBUILDING INDUSTRY REEVALUATE ITS NEED TO COMPETE FOR COMMERCIAL SHIP CONSTRUCTION ORDERS IN A SUBSIDIZED WORLD MARKET. CONSEQUENTLY, IN JUNE OF 1989, THE U.S. SHIPBUILDING INDUSTRY, REPRESENTED BY THE "SHIPBUILDERS COUNCIL OF AMERICA", FILED A CLAIM FOR INJURIOUS UNFAIR SUBSIDIES UNDER SECTION 301 OF THE U.S. TRADE LAWS AGAINST THE MAJOR SHIPBUILDING COUNTRIES OF THE WORLD.

LATER THAT YEAR, HOWEVER, U.S. TRADE AMBASSADOR CARLA HILLS, PERSUADED THE INDUSTRY THAT A BETTER WAY TO ELIMINATE THE FOREIGN SUBSIDIES WAS THROUGH MULTILATERAL NEGOTIATIONS. INDUSTRY DECIDED TO GIVE INTERNATIONAL NEGOTIATIONS A CHANCE AND THEREFORE WITHDREW ITS SECTION 301 CLAIM. THE FIVE YEAR O.E.C.D. QUEST TO ELIMINATE SHIPBUILDING SUBSIDIES HAD BEGUN.

FROM LATE 1989 TO LATE 1994, THE O.E.C.D. NEGOTIATIONS WERE CONSTANTLY ON AGAIN AND OFF AGAIN. DURING 1993, WHEN THE TALKS HAD SEEMINGLY COLLAPSED, I INTRODUCED A BILL IN THE SENATE (S. 990) AND CONGRESSMAN GIBBONS INTRODUCED A BILL IN THE HOUSE (H.R. 1402), THAT WOULD HAVE INVOKED SIGNIFICANT SANCTIONS AGAINST SHIPS CONSTRUCTED IN FOREIGN SUBSIDIZED YARDS WHEN THOSE SHIPS CALLED UPON THE UNITED STATES.

FROM JUNE 1989 UNTIL THE PRESENT AGREEMENT WAS SIGNED ON DECEMBER 21, 1994, THE U.S. OBJECTIVE AND THE INDUSTRY'S URGENT REQUEST APPEARED TO BE SIMPLE: "ELIMINATE SUBSIDIES AND WE CAN COMPETE." WHEN THE CLINTON ADMINISTRATION CAME INTO OFFICE, TO ITS CREDIT, IT PROPOSED A "SHIPYARD REVITALIZATION PLAN." I WOULD EXPECT THE ADMINISTRATION TO REVIEW THE COMPONENTS OF THAT PLAN TODAY AS ASSISTANT U.S. TRADE REPRESENTATIVE DON PHILLIPS DID FOR THE SENATE FINANCE COMMITTEE TRADE SUBCOMMITTEE ON NOVEMBER 18, 1993 WHEN HE SAID, AND I QUOTE:

> "FINALLY, THIS FIVE-POINT PROGRAM IS A TRANSITIONAL PROGRAM, CONSISTENT WITH FEDERAL ASSISTANCE TO OTHER INDUSTRIES SEEKING TO CONVERT FROM DEFENSE TO CIVILIAN MARKETS. IN ADDITION, IT SEEKS TO SUPPORT, NOT UNDERCUT, THE NEGOTIATIONS THAT ARE CURRENTLY UNDERWAY IN THE OECD. IN THIS REGARD, WE HAVE MADE CLEAR OUR INTENTION TO MODIFY THIS PROGRAM, AS APPROPRIATE, SO THAT IT WOULD BE CONSISTENT WITH THE PROVISION OF A MULTILATERAL AGREEMENT---IF AND WHEN SUCH AN AGREEMENT ENTERS INTO FORCE. " (EMPHASIS ADDED).

NOW WE HAVE SUCH AN AGREEMENT, BUT SOME U.S. SHIPYARDS DON'T WANT IT BECAUSE U.S. TRANSITIONAL SUBSIDIES WILL NEED TO BE CURBED IN ORDER TO BE CONSISTENT WITH THE AGREEMENT. THIS IS REALLY THE ISSUE IN A NUTSHELL. WE CAN TALK ABOUT THE JONES ACT, WE CAN TALK ABOUT THE TRUSTWORTHINESS OF OTHER COUNTRIES, WE CAN TALK ABOUT THE ADEQUACY OF ENFORCEMENT MECHANISMS, BUT WHAT IT REALLY SEEMS TO COME DOWN TO IS WHETHER OR NOT WE CAN KEEP OUR CURRENT ADVANTAGEOUS SUBSIDIES.

U.S.T.R: IS HERE TO DISCUSS SPECIFIC TRADE DETAILS SURROUNDING THE AGREEMENT. HOWEVER, I MUST SAY THAT IN ALL THE COMMENTS I HAVE HEARD TO DATE ABOUT THIS AGREEMENT, I HAVE YET TO HEAR OF A SCENARIO WHEREBY U.S. INDUSTRY IS BETTER OFF FIGHTING FOREIGN UNFAIR SHIPBUILDING PRACTICES WITHOUT THE AGREEMENT THAN IT WOULD BE WITH THE AGREEMENT. FOR EXAMPLE, THIS AGREEMENT WILL GIVE US REAL TOOLS TO FIGHT AN UNFAIR FRENCH SUBSIDY IF ONE SHOULD MATERIALIZE. IT WILL ALLOW US TO COUNTER THE UNFAIR DUMPING OF SHIPS BY JAPAN AND KOREA IF THAT SHOULD OCCUR. IT WILL FINALLY PLUG THE GAP IN EXISTING U.S. TRADE LAWS THAT HAS COST SO MANY AMERICAN SHIPYARD WORKERS THEIR JOBS.

THE ASSERTIONS THAT THIS AGREEMENT SOMEHOW PUTS THE JONES ACT DOMESTIC BUILD PROVISIONS IN JEOPARDY IS DISCREDITED BY OUR JONES ACT CARRIERS WHO WOULD HAVE THE MOST TO LOSE UNDER A FAULTY AGREEMENT. THE LARGEST JONES ACT CARRIERS, IN FACT, SUPPORT THE AGREEMENT AND THEY CLEARLY WOULD NOT IF THIS AGREEMENT HURT THEIR INTERESTS --IT DOES NOT.

IT ALSO SEEMS TO ME THAT THE OPTIMISM OVER THE CURRENT SUCCESS OF OUR TITLE XI FINANCING PROGRAM MAY BE OVERSTATED. AS I UNDERSTAND IT, THE NEW EXPORT ORDERS ASSOCIATED WITH THE CURRENT TITLE XI PROGRAM EXIST BECAUSE OUR STEPPED-UP TITLE XI PROGRAM IS CURRENTLY PROTECTED BY A STANDSTILL CLAUSE IN THE O.E.C.D. AGREEMENT. IF WE REJECT THE AGREEMENT, WE LOSE THE STANDSTILL CLAUSE, AND CONSEQUENTLY IT SEEMS TO REASON THAT WE WILL LOSE OUR CURRENT TITLE XI ADVANTAGE.

UNLESS WE ARE PREPARED TO WIN A SUBSIDIES RACE WITH OUR COMPETITORS, I DON'T UNDERSTAND HOW WE CAN REJECT THIS AGREEMENT. NOT ONLY IS CONGRESS FACED WITH DIRE BUDGETARY DECISIONS, SUCH AS CUTTING OVER $450 BILLION FROM MEDICARE AND MEDICAID OVER THE NEXT SEVEN YEARS, BUT THE DEPARTMENT OF DEFENSE HAS ALSO INDICATED THAT IT WILL NOT FUND COMMERCIAL SHIPBUILDING SUBSIDIES THROUGH ITS D.O.D. ACCOUNTS.

ADD HEIGHTENED COMPETITION DUE TO INCREASING WORLD SHIPBUILDING CAPACITY AND IT SEEMS TO ME, AND HISTORY SUPPORTS, THAT OUR COMPETITORS ARE VERY LIKELY TO MATCH OR EXCEED WHAT LITTLE AMOUNTS WE WILL BE ABLE TO DEVOTE TO TITLE XI. (IT WAS ESTIMATED BY THE SHIPBUILDERS COUNCIL IN 1993 THAT THE TOP SIX SUBSIDIZING NATIONS IN THE O.E.C.D. WERE BUDGETING OVER $9 BILLION ON AVERAGE EACH YEAR TO ASSIST THEIR SHIPYARDS.) WE MAY THEN FIND OURSELVES IN THE SAME UNTENABLE SITUATION THAT CONFRONTED OUR INDUSTRY IN 1981: NO INTERNATIONAL SUBSIDIES DISCIPLINES, INADEQUATE U.S. TRADE

REMEDIES AND NO RECOURSE FOR THE U.S. COMMERCIAL SHIPBUILDING INDUSTRY AND ITS WORKERS.

IN CONCLUSION, MR. CHAIRMAN, WE'RE ALL IN THE SAME "BOAT", SO TO SPEAK. EVERY WITNESS TESTIFYING TODAY UNDOUBTEDLY HAS THE BEST INTEREST OF THE U.S. SHIPBUILDING INDUSTRY AT HEART. HOWEVER, BEFORE ANYONE ATTEMPTS TO SCUTTLE THIS AGREEMENT THAT MAY BE OUR LAST BEST SHOT AT REVIVING A U.S. COMMERCIAL SHIPBUILDING INDUSTRY, I'D LIKE TO REDOUBLE EFFORTS WITH ALL MEMBERS OF THE INDUSTRY TO SEE WHAT WE CAN DO TO CLOSE THE REMAINING COMPETITIVENESS GAP. OUR GOAL SHOULD BE TO COUPLE THE SIGNIFICANT ADVANTAGES OF THIS AGREEMENT WITH GENUINE AND CREATIVE IMPROVEMENTS IN U.S. SHIPBUILDING COMPETITIVENESS.

I APPRECIATE THE OPPORTUNITY TO TESTIFY BEFORE YOU TODAY AND LOOK FORWARD TO WORKING WITH YOU TO PASS THIS VITAL LEGISLATION.

, 20-050/10

ASSISTANT SECRETARY OF DEFENSE
3300 DEFENSE PENTAGON
WASHINGTON DC 20301-3300

ECONOMIC SECURITY

March 16, 1995

Honorable John Breaux
United States Senate
Washington, DC 20510

Dear Senator Breaux:

Your letter to Secretary Perry regarding the Department's views on proposals for the Department of Defense to fund commercial shipbuilding subsidies was referred to my office.

We have not seen the proposal you mention, but would be unlikely to support it. As you know, the OECD agreement to end commercial shipbuilding subsidies is a centerpiece of the President's shipbuilding plan. Only by eliminating foreign shipbuilding subsidies will our shipyards be able to compete on a level international playing field. The Department of Defense could not support a proposal to provide subsidies for commercial shipbuilding that would be in violation of the OECD agreement.

We would certainly be opposed to funding any such program out of the defense budget. U.S. shipyards lead the world in the construction of naval vessels, and we will certainly act to maintain our edge in this area. However, we neither need, nor can we afford, to spend scarce defense dollars on programs that are not essential to our national security.

Sincerely,

Joshua Gotbaum

Joshua Gotbaum

Chairman CRANE. Thank you very much, Senator Breaux.

Mr. Gibbons.

Mr. GIBBONS. I first want to thank you for the splendid work that you have done on this issue for so many years. I wholeheartedly agree with you. This is the best trade agreement, Senator Breaux, that I have ever seen as far as fairness and as far as certainty and as far as getting rid of subsidies and injurious sales practices in the international shipbuilding area.

It does not, as you so ably pointed out, affect our rights on coastwise shipping, Jones Act shipping, and I cannot imagine the Congress ever coming back and enacting subsidies, when right here at this committee table we are going to have to cut $300-some billion out of Medicare and other programs in order to get to the balanced budget by the year 2002. There is just no way. Anybody that thinks we are getting back into the shipbuilding subsidy business has got to be dreaming.

It was not a good practice when we had it. The people that got it liked it, but the people that had to pay for it did not like it, and the people that have to pay for things now are sort of in charge of this government and this Congress. So I think that is where we stand.

Thank you for all your help.

Senator BREAUX. Thank you, Congressman.

Chairman CRANE. Mr. Houghton.

Mr. HOUGHTON. Thank you very much, Senator, for being here and for following up Mr. Gibbons' statement.

If this is so good, why does not everybody embrace this? Are there lingering doubts about title XI?

Senator BREAUX. I think three things, Congressman. Number one, I think that people always have concerns about whether treaties are enforceable or not enforceable; it may not work, therefore, we should not support it. I think Ambassador Lang can clearly talk in more detail than I about the enforcement provisions of the treaty.

I think this Agreement is, however, as solid as any international agreement we can ever achieve. The actions that we can take are strong. Failure to comply could result in the imposition of sanctions against the other countries. For example, GATT concessions could be withdrawn by the United States, if they do not comply. There is a very strong enforcement mechanism for the treaty. But the first thing they will point out, well, it may not be enforceable. I suggest that it clearly is better than most international agreements we have.

The second argument you may hear is that, well, we should not give up title XI which is our only program that helps shipbuilding. Number one, we do not have to do it right away. It only goes into effect on January 1, 1996, and we still have title XI after that. It just has to comply with international terms, that is, our 25-year loan guarantees go down to 12 years. We still have title XI and it still will be effective. We will still have it for domestic shipbuilding unrestricted.

The third argument will be, well, the Jones Act will be put in jeopardy. But every single major Jones Act operator, the companies that do Jones Act trade, Sealand, for example, and other groups I

mentioned, Aims and American waterway operators who are Jones Act operators, say this is a good agreement. They clearly would not be for it, if it damaged the Jones Act trade.

So those are the three arguments I think you would hear against it.

Mr. HOUGHTON. And if you represented Bath, Me., would you be saying those same words?

Senator BREAUX. I may not say it as eloquently as I am now. [Laughter.]

Mr. HOUGHTON. And if you were the Prime Minister of Spain, Portugal and Belgium, would you say the same thing?

Senator BREAUX. No, because they do not like this Agreement because it restricts their ability to have subsidies for their shipbuilding industries. They beat our brains in with subsidies in Japan, France, South Korea and other shipbuilding nations. These countries do not like this Agreement because it is going to make them have to compete on a level playingfield which they really do not want to do.

But I understand all the folks who represent the larger shipbuilding yards that have relied primarily on defense work, they know they are going to be building probably fewer defense ships. They want to get into the commercial market and they are afraid they cannot do it without the subsidies. I disagree with that. But even if that were true, does anybody think we are going to go back to shipbuilding subsidies? No.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. No questions.

Chairman CRANE. Mr. Ramstad.

Mr. RAMSTAD. No questions.

Chairman CRANE. Mr. Neal.

Mr. NEAL. No questions.

Chairman CRANE. We want to thank you again, Senator Breaux, for your testimony and your support over in the other body, and look forward to the successful conclusion after all these years of laboring in the vineyards by Sam Gibbons.

Senator BREAUX. Thank you, Mr. Chairman.

Chairman CRANE. With that, I would like to invite our next witness, Ambassador Jeffrey Lang, Deputy U.S. Trade Representative.

You may proceed, Ambassador Lang.

STATEMENT OF HON. JEFFREY M. LANG, DEPUTY U.S. TRADE REPRESENTATIVE

Ambassador LANG. Thank you, Mr. Chairman.

You and Mr. Gibbons and Senator Breaux have summarized the Agreement. We submitted our testimony to the committee yesterday afternoon, so I thought I would just summarize to give you an opportunity to ask questions.

We believe the Agreement will achieve the basic objective that the industry started out with when it approached us under section 301 5 or 6 years ago that was pushed by this committee, by the Congress generally, and by the previous administration of eliminating unfair foreign subsidies and other distortive practice in international shipbuilding.

I think the important benefits of the Agreement are the following four elements: First, there are very strong, unusually strong provisions eliminating subsidies granted either directly or indirectly to shipbuilding. The discipline imposed on these subsidies is more specific and it is tighter than is imposed in any other sector. It is tighter than the WTO subsidies agreement. I noted, for example, that the majority of subsidies, domestic subsidies and indirect subsidies, would require a proof of serious prejudice under the WTO. They do not require that proof under this Agreement. That is a very strong provision.

A second important component is the injurious pricing code which is designed to prevent dumping in the shipbuilding industry. Up to now, there has been no such remedy, because ships are not customarily imported, and the dumping law, of course, applies to products that are imported into the United States. So there has been no means of discouraging or dealing with dumping in the shipbuilding sector, and this gives us a remedy in that regard.

Third, there is a comprehensive discipline on government financing for exports and domestic ship sales that is designed to eliminate trade distorting financing. These existing rules on export credits and tied aid for ships are weaker and less effective than they are for other products, so the Agreement improves that situation.

Finally, as Senator Breaux pointed out, there is an effective binding dispute settlement mechanism. We have a penal system, the same sort of dispute settlement process that you have now in the WTO, and the remedy, a failure to comply with the panel's findings, can be sanctions, including the removal of GATT concessions. So, in effect, you have the benefits of cross-retaliation without the Agreement being under the aegis of the WTO.

Now, by virtue of these provisions, we think the Agreement will achieve several goals. First, it will be good for U.S. shipbuilding and the repair industry, because it will create a rational climate for international competition in this sector.

Second, it will be good for our maritime industry overall, because it will avoid damaging trade conflicts in the shipbuilding sector and the spillover of distortions in shipbuilding subsidies into the shipping sector.

Third, it is consistent with our broader shared trade and budgetary policies which aim at eliminating distortive government subsidies and avoiding unproductive government spending.

You have heard from Mr. Gibbons about the history of the negotiations. I just want to point out that significant growth is projected for this very competitive international shipbuilding market. While the domestic military and commercial markets are expected to decline, the statistics in this area are a little hard to come by, but global commercial shipbuilding is projected to amount to about $265 billion in the period from 1992 to 2001. That includes ships that are in production now, but not delivered yet. That is over 14,000 ships. There will be almost 10,000 ships built by 2001, and three-fourths of those will be begun after 1996. So this Agreement is going to have an impact on a very important sector of growing international trade.

At present, of course, U.S. participation in this market is minimal, because its efforts to penetrate the global commercial market

have been hampered by the foreign government shipyard subsidies. That is why the 301 investigation was brought 5 years ago.

But at a basic level, our domestic industry has a lot of highly competitive factors in its favor. It has competitive wage rates. We now have competitive steel pricing in this country. The value of the dollar in relation to the currencies of most other major shipbuilding nations is favorable for exports. We have a good basic infrastructure in this industry throughout the country. And we have a narrowing cost gap with other shipbuilding nations around the world. So if we deal effectively with the problem of foreign subsidies, we think the domestic yards can make good use of this Agreement to compete.

Now I want to turn for a second to the criticisms of the Agreement and just mention a couple of factors I would hope the committee would keep in mind. First, with respect to exceptions to these obligations under the Agreement, they seem to me to be extremely limited.

First, this government support for worker retirement, severance of retraining, obviously it is adjustment assistance in another form, and the key limitation on those payments is that they must be for the exclusive benefit of workers. Treatment which does not comply with the exceptions, of course, is actionable under the disputes settlement part of the Agreement.

Second, there is a provision on government assistance for research and development, but it also is limited, more limited than the R&D exception to the subsidies agreement in the WTO, and again actions that are not in accordance with the exception are actionable under the dispute settlement provisions.

Finally, there are restructuring assistance programs for Belgium, Portugal, and Spain. The purpose of these provisions and the limitations upon them are such that they can only be used for downsizing or closing shipyards. They will be allowed to continue for a limited period of time after the entry into force of the Agreement. We would have preferred not to grandfather these programs, there is no question about it. But they were already in training prior to the conclusion of the negotiations and would probably continue unconstrained if we had no agreement. So we think the country is better served by incorporating into the Agreement so that they are clearly circumscribed as to duration, amount, and purpose. At least we have got them under control.

And the final exception which cuts our way is to exempt the build in U.S. requirements that are contained in the Jones Act and our other U.S. cabotage laws. That is the only permanent exception to the Agreement rules, and we felt that, based on our contacts with the Congress and with the industry, we had to keep that exemption in the Agreement. I should emphasize that nothing in the Agreement requires us to change the Jones Act.

Now, the Agreement also includes a standstill provision that covers the period prior to entry into force in January 1996. That allows existing government programs to continue unchanged prior to 1996 for vessels delivered I think up to December 31, 1997. While this allows other countries to continue existing subsidy programs, it also allows us to continue title XI until the end of the year.

In short, the exceptions are limited, the subsidy provision is strong and broad, stronger than anything we have seen up until now, and we think that other countries are required to give up more than we are. For example, take the European Union. They are going to have to eliminate government grants to shipyards based on ship contracts or shipyard operation which amount to a percentage of contract value, as well as the normal equity infusions inconsistent with the provisions of risk capital. In the past, this so-called contract aid has been as high as 27 percent of contract price. It is now 9, but, of course, it could go back up without this Agreement.

The United States has no such elaborate and expensive government aid programs. However, we will be required to modify a number of programs to bring them into compliance with the Agreement, the operating subsidy differential, the cargo preference, the capital construction fund and the capital reserve fund. Signatory countries are also required to eliminate customs duties on newly built vessels and on vessel repairs. This will require us to eliminate the 50 percent ad valorem tax on ship repairs done abroad in other agreement countries—let me emphasize only agreement countries, not other countries.

The Agreement also requires us to harmonize the terms of our research and development programs, which means MARITECH, and our ship financing program, which is title XI, the loan guarantee program, with the Agreement. In the case of title XI, we will have to reduce the percentage of a ship's sales price that can be guaranteed from 87.5 to 80 percent, and the duration of the guarantee from the maximum 25 to 12 years. These new terms will apply to everybody else in the Agreement, of course.

We think these requirements are a reasonable price to pay for the disciplines I have described in the Agreement, which are tough and comprehensive. They are far more extensive, frankly, than ours. This outcome is also consistent with the negotiating objective that we started out with, which was to strictly discipline subsidy practices.

Now let me just mention what is required in terms of implementing legislation. There are four elements: First, we will have to authorize the injurious pricing mechanism contained in the Agreement. This will occupy a lot of pages, because we will have to bring over the existing provisions of the dumping law into a fresh statutory enactment, but it will not be significantly different from the antidumping law in terms of the standards of proof and all that kind of thing.

Second, we will have to modify the home-build requirement other than those pertaining to the coastwise laws to allow for the eligibility of ships produced in other agreement countries.

Third, we will have to eliminate the 50 percent ad valorem tax on ship repairs for agreement countries. And, fourth, we will have to modify the title XI ship financing program in the ways I have described earlier.

Our experts have been discussing these matters with the subcommittee staff and we hope to be helpful with you on all the technical aspects of getting your legislation framed and introduced.

In conclusion, Mr. Chairman, I think this is a good agreement. It accomplishes the objectives that we set out to accomplish, the previous administration set out to accomplish and the Congress set out for us. I think we ought to move ahead and get it into force as soon as possible.

Thank you very much.

[The prepared statement follows:]

TESTIMONY OF
AMBASSADOR JEFFREY LANG
DEPUTY U.S. TRADE REPRESENTATIVE

JULY 18, 1995

BEFORE THE TRADE SUBCOMMITTEE OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
REGARDING
THE OECD SHIPBUILDING AGREEMENT

I appreciate the opportunity to be with you today to discuss the OECD Shipbuilding Agreement (formally termed "The Agreement Respecting Normal Competitive Conditions In The Commercial Shipbuilding And Repair Industry"). The signing of this Agreement in December 1994 by the European Union, Japan, Korea, Norway, and the United States -- countries accounting for roughly 80 percent of global shipbuilding -- marked the conclusion of nearly five years of negotiations under both Republican and Democratic Administrations. The Agreement accomplished a key element of the "Shipyard Revitalization Plan" announced by President Clinton in October 1993 to strengthen the competitiveness of America's shipyards. While the impetus for these negotiations came from the US shipbuilding industry itself, Congress, and in particular this Committee, demonstrated a high level of interest in and support for the conclusion of an agreement throughout this process. It is therefore my pleasure to be able to report to you on this Agreement.

We believe that the Agreement will achieve the basic objective, jointly shared by our industry, Congress, and the Executive Branch, of eliminating unfair foreign subsidies and other distortive practices on international shipbuilding. It will thereby establish a level playing field that will enable our shipyards to compete successfully and win a significant part of the world commercial shipbuilding market. Therefore, we believe it is vitally important that Congress pass the legislation necessary to have the Agreement enter into force as scheduled on January 1, 1996.

The Agreement contains four major elements:

- The elimination of virtually all subsidies granted either directly or indirectly to shipbuilders. The discipline imposed on such subsidies is more specific and tighter than that imposed in any other sector and than that provided by more general disciplines of the WTO Subsidies Agreement.

- An injurious pricing code designed to prevent dumping in the shipbuilding industry. Up to now, there has been no such remedy. Since ships are not customarily imported existing antidumping laws are inapplicable.. Thus, there has been no means of discouraging or dealing with dumping in the shipbuilding sector.

- o A comprehensive discipline on government financing for exports and domestic ship sales designed to eliminate trade-distortive financing. Existing international rules on export credits and tied aid for ships are weaker and less effective than for other products. The Agreement will greatly improve this situation.

- o An effective, and binding, dispute settlement mechanism. Dispute settlement panels will be established, as necessary, to determine whether subsidy or other government measures are consistent with the Agreement and to ensure that the injurious pricing code is being properly implemented. Failure to comply with a panel's finding may result in the imposition of sanctions; for example, GATT concessions may be withdrawn by the complaining party in the event of failure to comply with a panel finding that a signatory government has bestowed prohibited subsidies.

By virtue of these provisions, we believe the Agreement will achieve several goals:

-- First, it will be good for the US shipbuilding and repair industry because it will create an economically rational climate in international shipbuilding that will give our shipyards the incentive to adapt to its requirements and enable competitive US yards to win contracts;

--Second, it will be good for our maritime industry overall because it will avoid the eruption of damaging trade conflicts in the shipbuilding sector and the spillover of the distortive effects of shipbuilding subsidies into the shipping sector;

--Third, it is consistent with broader trade and budgetary policies which aim at eliminating distortive government subsidies and avoiding unproductive government spending. Such subsidies skew the efficient allocation of resources, disadvantage non-subsidized parties, and represent a non-economic drain on public funds. At a time when we are all concerned about balancing the budget, avoiding subsidies is especially important.

History of the Negotiations

With the end of the Cold War and the downsizing of the U.S. Navy, U.S. shipbuilders realized they must take steps to compete in the global commercial market -- a market characterized by foreign government subsidies and predatory pricing practices. As a result, the Shipbuilders Council of America (SCA) in 1989 petitioned the U.S. Government under Section 301 to take action against the foreign subsidy practices of Korea, Japan, Germany and Norway. With the strong support of the SCA, and at the urging of numerous members of the U.S. Congress, the Bush Administration subsequently undertook multilateral negotiations under the auspices of the OECD aimed at the reduction or elimination of trade distorting practices of the important shipbuilding nations. These negotiations have been

long and difficult, breaking down completely in April 1992. Due to continued strong Congressional interest in an Agreement as well as President Clinton's desire to implement an effective program to strengthen our shipbuilding industry, they were revived in June 1993 and negotiations were substantively concluded in July 1994.

Throughout this negotiating process, USTR consulted closely with our private sector and with Congress. We have testified on three previous occasions before this Subcommittee and once before the previously existing Merchant Marine Subcommittee.

Significant growth is projected for the highly competitive international shipbuilding market, while domestic military and commercial markets are expected to be small. The global commercial shipbuilding market is projected to amount to $265 billion during the 1992 to 2001 period. At present U.S. participation in this market is minimal because its efforts to penetrate the global commercial market have been severely hampered by heavy foreign government shipyard subsidies. The OECD Agreement, by eliminating most shipbuilding subsidies, will create the environment for U.S. industry to compete for this growing market based on market forces. And we believe U.S. shipbuilders can--and will--compete successfully in such a global environment. There are a number of competitive factors favoring U.S. shipyards, including: competitive wage rates; competitive steel pricing; the value of the dollar in relation to the currencies of most other major shipbuilding nations; good basic infrastructure; a narrowing cost gap with other shipbuilding nations; and good production facilities. Throughout the negotiating process, our industry steadfastly asserted, in face of considerable skepticism by many observers within and outside the U.S., that, if the problem of foreign subsidies were effectively dealt with, they could make good use of these factors to compete successfully.

Criticism of the Agreement

Criticism of the Agreement has focused on three points: that it still permits some foreign government support ; that it does not allow for the introduction of new U.S. subsidy programs; and that it requires changes in U.S. programs. I would like to address these points.

There are four specific and limited exceptions to the Agreement's prohibition of subsidies and other distortive government practices.

- Government support is permitted for worker retirement, severance, or retraining associated with the closure or downsizing of shipyards -- but such assistance must be for the exclusive benefit of workers.

- Government assistance for research and development is allowed under certain conditions, provided it is granted in accordance with the terms of the Agreement.

- Certain restructuring assistance programs for Belgium, Portugal and Spain primarily intended to address the social cost of downsizing or closing shipyards will be allowed to continue for a limited time after entry into force of the Agreement. While, quite frankly, we would have preferred not to "grandfather" any such programs, they were already in train prior to conclusion of the negotiations and would no doubt continue, unconstrained, in the absence of an Agreement. We believe we are better served by incorporating them in the Agreement which clearly circumscribes them in terms of duration, amount, and purpose.

- The Agreement exempts "build in U.S." requirements contained in the Jones Act and other U.S. coastwise trade laws -- the only permanent exemption to the Agreement rules. Our soundings of Congress and the industry led us to the conclusion that no changes in these U.S.-build requirements were acceptable.

The Agreement also includes a "standstill" provision that covers the period prior to entry into force on January 1996.. The standstill allows existing government programs to continue unchanged prior to 1996 but prohibits the introduction of new subsidies or the increase in the level of existing subsidies during this period. While this allows other countries to continue existing subsidy programs until the end of this year, it also allows us to continue to operate our Title XI program according to existing rules.

In sum, the exceptions allowed are quite limited and, for the most part, benefit the U.S. as much as any other party. Combined with the dramatic overall improvement in discipline that will result from the Agreement, we believe this constitutes a fair and balanced package that will be greatly beneficial to US industry. Under the Agreement, other countries are required to give up their much more substantial support to their shipyards while only modest changes will be required to U.S. programs.

For example, the European Union (EU) will have to eliminate government grants to shipyards based on ship contracts or shipyard operation, which amount to a percentage of contract value, as well as equity infusions inconsistent with normal provision of risk capital. In the past such, so-called "contract aid" has been as high as 27 percent of contract price. (It is now 9 percent.) Except for the few "grandfathered" programs, I have mentioned restructuring support, including debt forgiveness, which has been common in Europe, Korea and Japan, will not be allowed other than for worker assistance tied to shipyard closures or capacity reductions. Thus, the restructuring program for East German shipyards introduced in 1992 at an estimated cost of $2-3 billion would not be allowed under the terms of the Agreement.

The United States has no such elaborate or expensive government aid programs. However, we will be required to modify a number of programs to bring them into compliance with the Agreement. These programs are the Operating

Subsidy Differential, Cargo Preference, Capital Construction Fund and the Capital Reserve Fund. These programs currently have so-called "home build" provisions, which limit their applicability to ships built in the United States. The home build aspects of these programs will have to be changed to permit eligibility of ships built in other other OECD Agreement countries. However, as noted above, the home build requirements of our coastwise trade laws (Jones Act) will not be modified. Signatory countries are also required to eliminate any customs duties on newly built vessels and on vessel repairs. This requires us to eliminate our 50 percent ad valorem duty on ship repairs done abroad in other Agreement other Agreement countries. Let me underscore that the benefits of these changes will be limited to OECD Agreement countries; countries not undertaking the disciplines of the Agreement will continue to be ineligible for these programs and subject to the ship repair duty.

The Agreement also requires us to harmonize the terms of our research and development programs (e.g. MARITECH) and our ship financing program (Title XI loan guarantee program) with the terms of the Agreement. In the case of MARITECH, the program will have to be administered to ensure that government assistance is provided as a percentage of the cost of a project and is limited to amounts set out in the Agreement -- 50 percent for basic industrial research, 35 percent for applied research, and 25 percent for development projects. In the case of Title XI guarantees for export and domestic financing, we will have to reduce the percentage of a ship's sales price that may be guaranteed from 87.5 percent to 80 percent, and the duration of guarantee from a maximum of 25 years to 12 years. These new terms will also apply to other Agreement signatory countries.

We believe that these requirements are a reasonable price to pay for the tough and comprehensive disciplines the Agreement will impose on the government support programs of our trading partners -- which have been far more extensive than ours. This outcome is consistent with our overall negotiating objective of strictly disciplining subsidy practices while, at the same time, allowing the continuation of effective U.S. promotional programs.

Legislation Required

In order for the Agreement to enter into force as scheduled on January 1, 1996, Congress must enact implementing legislation.

Implementing legislation must include the following four elements:

- First, authorization to implement the injurious pricing (antidumping) mechanism contained in the Agreement. This will be the longest and technically most complex portion of the legislation. The provisions on injurious pricing track those adopted last year to implement the WTO Anti-Dumping Agreement but are modified to address the special features of the shipbuilding Agreement and the nature of ship transactions.

- Second, the legislation must provide for modification of "home build" requirements, other than those pertaining to the coastwise laws, to allow for the eligibility of ships produced in other Agreement countries.

- Third, elimination of the 50 percent ad valorem tariff on ship repairs for Agreement countries.

- Fourth, modification of the Title XI Ship Financing program to ensure that the terms and conditions of such financing will be in accordance with Agreement rules.

Our experts have been discussing these matters with Subcommittee staff, in particular, the technical aspects of injurious pricing, and are hopeful that we will be able to work together quickly to develop and introduce appropriate legislation. Because the elimination of ship repair duties will result in a small revenue loss, we will also need to develop revenue offsets to meet PAYGO requirements. We are still discussing appropriate offsets within the Administration but believe such offsets can be derived from modest changes in the rules governing certain maritime programs. We look forward to working with the Committee to come to a practical solution of this relatively minor problem.

Conclusion

The end of the Cold War and the rise of the global economy have created new challenges and new opportunities. American workers and companies can compete and win in global markets when success is based on quality, innovation and skill, rather than on government subsidies or predatory pricing. Americans do not fear open and fair competition. But they insist on a level playing field where everyone plays by the same rules. The Shipbuilding Agreement allows the U.S. shipbuilding industry to compete by restoring fair competitive conditions to the market--rather than retreat to the destructive game of an ever escalating subsidy war. It will open substantial new markets and opportunities around the world, and create jobs, for the U.S. shipbuilding industry.

We believe it is essential that legislation be enacted this year to implement the OECD Agreement as scheduled on January 1, 1996. Absent passage of legislation, we believe there is a very strong possibility that the Agreement would unravel, resulting in the indefinite continuation of an international shipbuilding market grossly distorted by foreign government subsidies and badly skewed against our shipyards. At minimum, it will lengthen the period during which foreign yards benefit from subsidies to the detriment of our yards.

Mr. Chairman, the Agreement is supported by a broad coalition representing shipyards, most suppliers to shipbuilders, most repair yards, most ship operators, some maritime unions, and state port authorities. Adoption and implementation of the disciplines contained in the OECD Shipbuilding Agreement is the only viable path to follow if our industry is to seize the opportunities offered by the world

commercial shipbuilding market.

Mr. Chairman, thank you for this opportunity to present our views today. I look forward to working with you in the coming months to ensure passage of legislation.

Chairman CRANE. Thank you, Ambassador Lang.

Specifically, Mr. Ambassador, I would appreciate it if you could confirm for me that France has not received any special exemptions in the Agreement.

Ambassador LANG. No, I am not aware of any. There are none.

Chairman CRANE. Second, with respect to injurious pricing, Mr. Bowler states in his testimony that the injurious pricing mechanism in the Agreement is ineffective, because U.S. petitioners may bring cases only against shipbuilders that are U.S. nationals. Could you clarify how the injurious pricing mechanism works?

Ambassador LANG. That does not sound right to me. I mean the injurious pricing mechanism applies to a foreign manufacturer who sells a ship to a U.S. buyer, and a U.S. buyer is defined very broadly as any person who is controlled by a U.S. citizen, and control definitions, as you know, under the dumping law are very low. I think it is 25 percent.

So the main respondent in these investigations is a foreign manufacturer of a vessel who is dumping, so the Agreement clearly reaches that situation. I do not think that is the case under the Agreement. It is not only applicable to U.S. buyers. There will always be a U.S. buyer involved, of course, because someone has to buy the vessel in order for the dumping to be actionable. But the target in the investigation is going to be the foreign manufacturer who sells the vessel at less than normal value.

Chairman CRANE. Thank you, Mr. Ambassador.

Mr. Gibbons.

Mr. GIBBONS. No questions, Mr. Crane. I just want to thank Ambassador Lang and the rest of his staff under various administrations, both Republican and Democrat, for having pushed this and having done such a good job. As I have said before, I have never seen an international agreement that was as comprehensive as this. I wish all international agreements could reach this stage of perfection.

Thank you and congratulations for a job well done.

Ambassador LANG. Thank you, Mr. Gibbons. On behalf of all my predecessors, we thank you, as well.

Chairman CRANE. Mr. Coyne.

Mr. COYNE. No questions.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Welcome, Ambassador Lang. I want to thank you for the good job that you have done since you have come to the USTR very recently.

Following up on a question the Chairman just asked, just to make sure I understand, you had talked in your testimony about the exceptions that were permitted under this Agreement in the four areas that you pointed out to us. I have heard that there is some sort of agreement with the French for some $480 million transition for a restructuring program for that country. Is that not considered to be a part of this Agreement or any other discussions relative to this Agreement?

Ambassador LANG. There have been rumors that the Government of France intends some kind of additional subsidy program. They are not within any exemptions from this Agreement. They are going to have to live up to the full obligations of the Agreement.

Under European law, as I understand it, any additional subsidy program from any community government would have to be presented to the commission in Brussels for approval, or else it would be vulnerable to having to repay that subsidy. We are monitoring this rumored program very closely. There is a lot of transparency in the Brussels process. If France requests approval of the subsidy, we will find out about it and we will make it very clear to them that if a program in our opinion does not meet the standards of the Agreement, we would object to it. So I do not see that as a risk.

Mr. PAYNE. At this time, as it relates to the Agreement that is before us, the French program is not an exception?

Ambassador LANG. No.

Mr. PAYNE. And to the extent that there is such a program, then we would insist that it conform to the Agreement that is before us at the present time?

Ambassador LANG. Yes, sir.

Mr. PAYNE. The third implementing legislative item that you have is the elimination of the 50 percent ad valorem tariff on ship repairs. What will be the cost to the Treasury of this particular legislation?

Ambassador LANG. There is some disagreement about this matter, in fact. The tentative internal estimate is $50 million over 5 years, but we have some information from the industry, which I think they have submitted to both CBO and OMB, to suggest that the amount may be less than that, something on the order of $20 million over 5 years. Obviously, we will have to clarify what CBO's estimate would be in coming up with a PAY–GO that would be acceptable in this case. In any event, it is a relatively small amount of money.

Mr. PAYNE. In terms of the PAY–GO amount, has there been some determination of what would be in order to pay for this particular provision?

Ambassador LANG. Not yet. We are working within the administration to come up with a recommendation on the PAY–GO, but we certainly are prepared to work with you all on how to do that.

Mr. PAYNE. And that recommendation would be to us before we would act on this particular legislative provision?

Ambassador LANG. Yes.

Mr. PAYNE. Thank you very much. I have no other questions.

Chairman CRANE. Thank you.

Mr. Neal.

Mr. NEAL. Briefly, Mr. Chairman.

Mr. Ambassador, the Agreement's enforcement mechanisms, are you satisfied and confident that they can be carefully adhered to?

Ambassador LANG. Yes, I think so. It is essentially an imitation of the enforcement system we have in the WTO, with the additional advantage that, even though we do not have all the members of the WTO in the Agreement, we have the benefits of GATT retaliation against all these countries, all of whom are major exporters to the United States of a lot of things besides ships. So it is a pretty substantial enforcement mechanism.

Mr. NEAL. Do we leave ourselves room to renegotiate, if necessary?

Ambassador LANG. Well, we always have opportunities to renegotiate. I am not sure what you might be referring to in that regards.

Mr. NEAL. Well, if we are dissatisfied at some point with the process, is there room to make changes.

Ambassador LANG. Like every one of these trade agreements, there are withdrawal provisions and there is a committee established under the Agreement that meets on a regular basis. In most cases, if we have problems with the operation of an agreement like this, we would bring them up in those committee meetings, and often we are able to resolve them without having to go to extremes.

Mr. NEAL. Thank you, Mr. Ambassador. Thank you, Mr. Chairman.

Chairman CRANE. Thank you again, Mr. Ambassador, and congratulations for your outstanding work.

Ambassador LANG. Thank you, Mr. Chairman.

Chairman CRANE. With that, we will move to our next panel, three of our distinguished colleagues from the House, Herb Bateman of Virginia, Sonny Callahan of Alabama, and James Longley of Maine.

We will commence first with you, Mr. Bateman.

STATEMENT OF HON. HERBERT H. BATEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. BATEMAN. Thank you very much, Mr. Chairman and members of the committee.

I certainly want to express my deepest appreciation for allowing me the opportunity to appear before you on a matter of such importance to my district and to the nation as a whole.

I have more than a passing interest in shipbuilding. For more than 50 years Newport News, Va. has been my home. Newport News Shipbuilding located in my hometown is the largest shipbuilder in the Western Hemisphere. Some 21,000 men and women enter the shipyard's gates every day. That figure unfortunately is down from more than 31,000 just a few years ago. For the last 15 years, the shipyard has dedicated its efforts to building the finest warships in the world, from aircraft carriers to submarines for the U.S. Navy.

With the Navy shipbuilding account declining dramatically over the next 5 years, this yard, as well as others, must move into a commercial building program. Obviously, some yards are making the transition faster than others, and I am extremely proud to represent many of those skilled workers employed at the shipyard that is at the forefront of a successful transition.

This brings me to the issue before you today, the implementation of the OECD Agreement.

I am not here to argue the merits of subsidies. In fact, from the standpoint of the post-1999 time period, I cannot offer serious objection to its terms, assuming our trading partners adhere to it. I do strongly resent and object to the fact it appears to sanction subsidies granted by any nation for an interim period until 1999, except, that is, for the United States of America.

My present view is that our negotiators, in their quest for an OECD Agreement at any cost, simply lost sight of the fact that few,

if any, of our shipyards could in 1 short year transition to a viable commercial shipbuilding program.

By way of background—and I will be brief—the United States ended its major subsidy program in 1981, when funding for the construction differential program was terminated. Since then, our shipyards have done almost exclusively Navy work. During that timeframe, our foreign competitors concentrated their efforts on commercial shipbuilding. This concentration did not occur without significant subsidization by their governments.

Since the mideighties, restructuring aid in the form of grants, capital infusions, subsidized interest, government loans and tax writeoffs were offered by the governments of Japan, South Korea, Germany, Spain and Italy. Collectively, these countries budgeted over $8.5 billion just for restructuring, all at a time when the United States provided no assistance to its shipyards.

It has only been in the last several years that the United States has in any way assisted its yards in making the transition. I am referring to the very modest title XI loan guarantee program which I will comment briefly on in a few moments.

Not only has the past infusion of $8.5 billion into foreign shipyards given them a marked advantage, it appears that, at a minimum, the restructuring assistance granted to Belgium, Portugal and Spain is exempted and will continue.

In the case of Korea, its government has a $1 billion bailout program that runs to the year 2007.

And before the ink was barely dry on the Agreement, the French negotiated a sidebar agreement to provide up to $480 million in new financial assistance to its two major shipyards. This is occurring while the U.S. Congress is being told we cannot start any new transition programs.

Let me comment parenthetically that this French sidebar agreement, as I have referred to it, was negotiated between the French and the European Union partners and concluded last December. I have asked both abroad, as well as through our Trade Representative, for the details on this Agreement, and to date nothing has been forthcoming. But there is no question that the French were able successfully to negotiate a $480 million package, and we at least are entitled to know the terms and conditions of that package.

Despite my inquiries, we do not have that information.

The key point in this discussion is that many of our foreign competitors have had such a head start on commercial shipbuilding, that we can never catch up, or they have negotiated exemptions to allow their restructuring subsidies to continue well beyond 1996.

In conclusion, let me comment on the one modest program that is available to our shipbuilders now. Referred to as the title XI loan guarantee program, it was recently reauthorized in the fiscal year 1994 Defense Authorization Act, and this was after a decade of dormancy.

I mention title XI because it is illustrative of the unfair impact this Agreement will have for our shipbuilders. What does this Agreement do to title XI? It takes a 25-year financing program and dictates that the maximum loan term will be only 12 years. It takes a current equity requirement of 12.5 percent and makes the downpayment 20 percent. And it takes our lower U.S. market in-

terest rate and dictates an apparently higher international uniform rate known as the SEER rate.

These new provisions become effective for contracts signed after January 1, 1996. In practical terms, our shipbuilders must sign all of their contracts for all new vessels to be built under title XI in the next 5 months.

The net effect is that our shipyards have had less than 2 years to retool their assembly lines, market a product they have not built in 20 years, and then sign a binding contract. This is a virtually impossible task. Thus, the one and only program open to U.S. builders is history in 5 months. Yet, the billions of dollars in subsidies granted to our competitors in past years and in future years will continue to widen the gap.

Finally, members of this committee should not leave here today thinking that it is higher labor costs or inefficient work rules that continue to make our yards "uncompetitive." Our wage levels in shipyards are on a par with those in Korea and Japan and much less than those in Germany. If wage rates were the problem, why did BMW, Mercedes, Honda, and Toyota decide to establish factories using U.S. labor?

What our shipyards require is simply the opportunity to move down the learning curve that can only come from actually building ships. The title XI program gives them that opportunity. In my opinion, this Agreement as negotiated and implemented will forever prevent our shipyards from reentering the commercial market.

As aide and in addition to my comments on title XI, I would like very briefly to express concern over what I perceive to be an inappropriate intrusion into the domestic build requirements of vessels which serve solely and exclusively in our domestic trade. After the Agreement is in effect for 3 years, any coastwise vessel deliveries results in a rebuttable presumption that the United States violated the Agreement's terms. It would appear then that by signing the OECD Agreement, the United States will be tacitly acknowledging that the Jones Act will ultimately require repeal, if our U.S. yards are to have complete and equal access to international markets.

Mr. SHAW [presiding]. If the gentleman could conclude his remarks, the balance of the statement will be put in the record.

Mr. BATEMAN. That is the conclusion, Mr. Chairman. I appreciate the indulgence.

Mr. SHAW. Thank you.

The gentleman from Maine, Mr. Longley.

STATEMENT OF HON. JAMES B. LONGLEY, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MAINE

Mr. LONGLEY. Thank you, Mr. Chairman and members of the subcommittee, for the opportunity to testify here this morning.

I have the honor of representing the people of Maine's First District, home of Bath Iron Works, Maine's largest employer, which has been building ships for America's defense and commerce for 110 years, since 1884.

Shortly after my election to Congress last November, I began a series of visits to our Nation's other major Navy shipbuilding yards, including yards in five other States, seven other yards, as

well as to gain a better understanding of the industry, its unique capabilities and its important role in our national security.

It is truly breathtaking to witness firsthand the construction of our Navy's most sophisticated surface combatants, submarines, aircraft carriers and large auxiliary ships. The skills and dedication of American shipbuilding workers is unmatched in the world.

As a member of the House National Security Committee, I am particularly concerned that our country maintains a shipbuilding industrial base capable of meeting current and future defense requirements. These shipbuilders are too critical to our Nation's defense. We cannot afford to lose them.

Unfortunately, several circumstances make me fear for the future of our shipbuilding industry, and, in turn, for our long-term national security needs. The President's fiscal year 1996 budget for Navy shipbuilding marks the lowest level of funding for shipbuilding in nearly 50 years. Only three new warships are included in the budget, the lowest number since 1932.

In spite of low projected Navy shipbuilding budgets for the next 5 years, by decade's end the Navy will require a substantial ramp-up to a shipbuilding procurement rate of more than 10 ships per year in order to have any chance whatsoever of maintaining a minimal 346-ship Navy fleet, as identified in the administration's current defense bottom-up review.

If our shipbuilders are to survive and preserve the special skills of their workers, they must capture commercial ship construction orders in order to supplement their declining Navy work.

The OECD Shipbuilding Agreement is not the solution. It will in all likelihood make it more difficult, if not impossible, for U.S. shipbuilders to pursue commercial shipbuilding orders in the international market. This Agreement permits other governments to continue direct shipbuilding subsidy payments to their shipyards until 1999, as long as those subsidies are committed by the end of this year.

The last direct U.S. commercial shipbuilding subsidy program was unilaterally terminated by our government in 1981, nearly 15 years ago. In the period of time since then, we have seen a decline of nearly 100,000 jobs and well over half the yards have gone out of business.

I find it appalling that U.S. negotiators took part in formulation of an agreement in which numerous exceptions are granted to specific subsidizing foreign governments that total billions of dollars. How this combination of provisions does anything other than make the international commercial playingfield even more lopsided against unsubsidized American shipbuilders escapes me.

A French subsidy package reportedly in the range of $500 million was accepted by the European Union after the OECD Agreement negotiation had concluded and our negotiators had returned home. That event alone should have provided more than ample reason for our government to insist on reopening the negotiations in order to gain more equitable treatment for the unsubsidized U.S. industry. Other subsidies tolerated by the Agreement include subsidies to Spain, $1.5 billion, Portugal, $110 million, and Belgium, $74 million.

Again, as I indicated, if money is committed by January 1, 1996, those subsidies can be paid out until January 1, 1999. Those total an average prior to 1993 in the case of South Korea almost $2.5 billion a year, Germany nearly $2.5 billion a year, Japan almost $2 billion a year, and Italy almost $1 billion a year. These other nations have a financial jump start on the shipbuilding process that makes the concept of a level playingfield ludicrous.

It is unfortunate, to say the least, that the administration has chosen to ignore this information and did not respond favorably last December to the formal request of the six major U.S. shipbuilding companies, which represent over 95 percent of all active American shipbuilding workers, that the United States not sign the Agreement in its present form.

It is our responsibility in the Congress to prevent further devastation of this industry. We must not enact implementing legislation in haste, and I need to point out that, even months after the Agreement has been executed, we have yet to see any implementing legislation. And I point out to the committee that we are now holding a hearing on implementing this treaty, and we have yet to see the legislation from the administration.

I also would like to submit for the committee's attention a letter from the Acting Assistant Secretary of the Navy for Research and Development, Admiral Bowes, which was sent in response to a letter from Senator Cohen, Maine's senior Senator and the chair of the Senate Armed Services Committee's Seapower Subcommittee, pointing out that Navy's strong concern over the future of our naval shipbuilding industrial base and the critical importance that the Navy's leadership places on U.S. shipbuilder efforts to capture a share of the world commercial shipbuilding market.

Thank you for the opportunity to testify before you today on this Agreement.

[The letter referred to follows:]

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

The Honorable William S. Cohen
Chairman, Seapower Subcommittee
Committee on Armed Services
United States Senate
Washington, DC 20510

JUL 12 1995

Dear Mr. Chairman:

Thank you for your letter of June 26, 1995, to the Secretary of the Navy concerning the Naval shipbuilding industrial base. I am responding for Secretary Dalton.

The issue you raised concerning the need to sustain our critical Naval shipbuilding industrial base is one I share as being one of my highest priority and of critical importance to the Navy. The shipbuilding industry must be well positioned to meet the increased demand for new ship construction during the next decade, and there is little doubt that commercial and foreign military sales will play an important role in this endeavor.

I fully support efforts both in and outside the Department of the Navy which provide all shipyards engaged in naval ship construction with non-Navy industrial work that expands their business base, reduces overhead of Navy ships in construction, and maintains their skilled labor and engineering workforce. Augmenting Navy ship new construction with commercial shipbuilding, repair work, and foreign military sales will directly benefit Navy construction programs.

Efforts underway to strengthen the Nation's shipbuilders are vitally important. I see the need to strongly support programs such as the Maritime Technology program to foster manufacturing and information technologies for ship design and production; the Maritime Administration Title XI loan guarantee program (as amended to include guarantees for export vessels) to provide financing incentives to buyers of U.S. ships; international marketing assistance; and reduction of unnecessary government regulations affecting shipbuilders.

It is important that U.S. shipbuilders capture a share of the world shipbuilding market to ensure viability of this industry and to benefit the Navy by reducing new construction costs. I look forward to working with your Subcommittee in exploring these and other initiatives to foster non-Navy commercial work and to strengthen our Navy's shipbuilders.

As always, if I can be of further assistance, please let me know.

Sincerely,

W.C. BOWES
Vice Admiral, U.S. Navy
Principal Deputy

Mr. SHAW. Thank you.

Our final witness on this panel is the gentleman from Mobile, Ala., Sonny Callahan.

STATEMENT OF HON. SONNY CALLAHAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ALABAMA

Mr. CALLAHAN. Thank you, Mr. Chairman. I will submit my statement for the record and just tell you one reason I am here. Mobile, Ala., is very rich in the shipbuilding industry. When Mr. Gibbons was fighting his way through Europe, the people in Mobile, Ala., were building the tankers and building the supply ships to support you there. We built more than 140 ships during a very small time period to support our troops in Europe. So we are very rich in history with respect to shipbuilding.

Since I have come to Congress, I have chaired a committee that called for the revitalization of the shipbuilding industry here in the United States. Some of us that had interest in shipyards have tried desperately to try to get our shipyards on a level playingfield with the rest of the world with respect to shipbuilding. We worked with the Coast Guard to stop some of the onerous activities that they were causing, some of the competitive disadvantages they were causing. We worked with Usher. We have worked with everybody trying to position our shipyards, and finally we have positioned our shipyards to become a force once again in the world's shipbuilding business.

The only thing now that stands in our way is foreign competition and foreign subsidies. When we came forth with the OECD Agreement, when we came forth with that, that was the reason we did it, to make the rest of the countries compete with our shipyards on a fair and equal basis. If we stop now, you will set back shipbuilding in this country for a decade. We will never get these people back to the table again.

Let us continue to refine it as best we can, but let us not do anything to preclude the possibility of trying to get foreign competition to work with us in denying subsidies to their shipyards. Let us work in such a manner that will create a job capability for this country, instead of encouraging companies to move to a foreign country. If we do not pass the OECD Agreement or if we do not continue on that vein, we are putting our shipyards at a tremendous disadvantage.

I know that the wisdom that is collected just at this table alone with Mr. Neal, Mr. Coyne, Mr. Gibbons, and you Mr. Shaw, and our colleagues Mr. Houghton and Mr. Zimmer, certainly you all recognize that what we are trying to do is in the best interests of American jobs. And without a continuation of this Agreement, we are going to be without American jobs. I know you would have no part of that, so I am optimistic, especially after you read my testimony that I did not belabor you with this morning, I am optimistic that you will be even more convinced of our position and that you will do as we are requesting.

Thank you, sir.

[The prepared statement follows:]

STATEMENT OF CONGRESSMAN SONNY CALLAHAN

Mr. Chairman, Members of the subcommittee, thank you for the opportunity to appear before you today in support of the Organization for Economic Cooperation and Development (OECD) agreement to end international subsidies in shipbuilding and ship repair. I believe that it is an agreement which is enforceable and which will give competitive U.S. shipyards the opportunity to reenter the international commercial shipbuilding marketplace, a marketplace that is rapidly growing as a result of this committee's approval of the NAFTA and GATT Agreements. Trade is up, shipbuilding is up and U.S. shipyards need this agreement in order to obtain a fair market share.

You may ask why Sonny Callahan cares about this bill. The clear fact is that Mobile, Alabama has a proud tradition of shipbuilding. During World War II for example, while Sam Gibbons was fighting his way through Europe, several hundred ships were constructed in Mobile for the war effort including 142 at the Alabama Drydock and Shipbuilding Company, now operating as Alabama Shipyard, Incorporated. Of that number, 102 were T-2 tankers, the workhorse of the Merchant Marine during that period. Many other ships were built in parts of what now comprises the facilities of the Bender Shipbuilding and Repair Company.

As late as the early 1970s over 10,000 people were employed in Mobile in the construction and repair of oil drilling rigs, offshore production platforms and supply boats.

Now, after many years during which U.S. shipyards were denied access to foreign markets by immense foreign government subsidies, we in the Congress have an opportunity to assist in bringing those subsidies to an end. We firmly believe that if the U.S. ratifies this agreement, the other signatories will also ratify. If we, as the nation which initiated the negotiations, do not act responsibly now, the agreement will fail and it will be many years, if ever, before we have this opportunity again.

The shipyards of my district are already making international progress. Alabama Shipyard has a contract to build three chemical tankers for a Danish owner and Bender Shipbuilding has a deal with Russian owners for seven reefer ships and at least two anchor handling tug supply vessels for Brazilian owners. Thus, I conclude, these yards are already competitive, even before the subsidies are lifted and even though they do not have Navy construction contracts from which large profits may be diverted in order to offer competitive commercial prices. Therefore, I believe that these Mobile yards, like those already doing Navy work, should be considered as national security assets. These yards certainly have the capability to build Navy ships.

Mr. Chairman, like this committee, I believe in free and fair trade. In my opinion, this agreement not only offers that opportunity but also provides strong and enforceable provisions in the event that a

competitor should try and aid its shipyards in the future. The role of the U.S. government in today's global economic environment should be to work toward the elimination of all subsidies at home and abroad.

I am certain that my distinguished colleagues from Virginia and Maine would agree with that premise. We deal on a daily basis with these international economic issues in the Appropriations subcommittee I chair. It is clear to me that those yards that believe in their own capabilities and which are willing to back those beliefs in the cauldron of overseas competition should be supported by this committee and this Congress.

Some Members of Congress have noted their disappointment with the agreement and urge its disapproval and the reopening of negotiations. I would remind them that 1) these negotiations took five years to bring to closure and then only with the threat in place of the draconian Gibbons/Breaux legislation; 2) in the absence of this agreement, ongoing overseas subsidy practices will be continued and likely expanded; 3) if we disapprove, it will be difficult to get all of the present signatory nations back to the table, and frankly, I would doubt the will of the Clinton Administration and the U.S. Trade Representative to support such an effort; 4) it is highly unlikely in today's fiscal and economic climate that this Congress can find adequate funds to enter a shipbuilding subsidy war, particularly for an industry whose largest members oppose the very agreement begun at their behest. This agreement is our best chance in this century to help our shipyards survive the future economic challenges and we must act affirmatively in their behalf.

I thank you again for the opportunity to appear before you this morning and urge your support of this important legislation.

Mr. SHAW. Thank you.

Mr. Gibbons will inquire.

Mr. GIBBONS. I have listened very carefully to what you gentlemen have to say and I respect each of you. Mr. Longley, the information you gave and the information I get from my staff are entirely different. The only subsidies that are continued to go on are downsizing subsidies for those three small European countries who are trying to downsize their shipyards and lay off their employees, and the government is so involved in it that they have some benefits that they have got to continue paying like pension rights and retraining programs and things of that sort. But it is not to increase their shipbuilding capacity.

I think all of us must recognize that the title XI subsidy, as you say, violates the world's standard that we establish here, and if we do not put that world standard in place, everybody else will immediately go to our standard or outdo us in the subsidy on title XI That title XI subsidy will not last any longer than it takes you to snap your fingers.

We have got an advantage because right now we are under a standstill arrangement in this treaty, and other countries cannot match our title XI subsidies. But they can, as soon as we signal to them that this Agreement is not going not be ratified, and they will, because they always have for 230 years of the shipbuilding history of this country. We have always been outsubsidized by our foreign competitors.

You all know the budget crunch as well as I do, and I really cannot see this Congress coming up and subsidizing these yards in their commercial work any more. It is just not going to happen. So I think we need to all work together and get this Agreement put in place as rapidly as we can and vigorously enforce it.

As Ambassador Lang said, he has heard rumors of an agreement between France and the European Union, but before it can be implemented it has got to be made public, and we can retaliate against the European Union and against France if they put any subsidy agreement in place like that.

I am in great sympathy with the fact that you all are trying to vigorously represent your constituencies, but I think you are not being realistic when you think there is going to be any continuation of subsidies by the United States.

Mr. BATEMAN. Mr. Chairman, if I might briefly respond. First, let me address the matter of the French so-called sidebar agreement At the time the signing of the basic agreement was announced, it was replete with newspaper accounts about the degree of discomfort and agitation on the part of the French and their government and with their threatening the exercise of a veto power that they can inflict under extraordinary circumstances as defined by them.

In the following weeks of that then came an announcement that there had been negotiations and a $480 million deal struck. Last December, in Paris, I raised questions at a North Atlantic Assembly meeting of the OECD bureaucracy, and no one denied that an agreement had been made. Yet, no one has any details as to the nature and terms of that agreement. I think the committee should make it a part of its agenda to find out what it is.

I am not here asking for subsidies for American shipbuilding in order to violate the marketplace. I am here because the timing of this Agreement and the international shipbuilding marketplace is such that allowing transition programs for other foreign countries from now until 1999 cuts the legs out from under the opportunity that American shipbuilders would have in order to make the transition from a nonsubsidized status that we have been under for the last 15 years to where we can then compete on an even playingfield.

But without that, what we are doing is effectively denying to American shipbuilders who concentrated and built only naval vessels for the last 10 or more years the opportunity to get on that playingfield. If the transition rules never allow us to put a team on the field, having a level playingfield is of little benefit to us.

What we are talking about here, as Mr. Longley very appropriately emphasizes, is a national security concern. Without that, there would be no reason for us to suggest any subsidy or transition benefits of any kind. But there is a national security interest.

Mr. LONGLEY. Could I just add something very quickly. I recognize that you are under a time pressure. Mr. Gibbons, this is not a plea for subsidies or for continuation of subsidies. I want to point out something that I think is very important.

I will not speak about foreign policy in general, but with respect to this specific agreement, it is very clear to me that we have an administration that has not stood up for American interests and has acquiesced in continuation of a significant stream of subsidy payments that will amount to a complete disadvantage to American shipyards. And what we are calling for is a true level playingfield, not a posturing level playingfield, but a true level playingfield, and we do not have that.

Mr. SHAW. Mr. Zimmer.

Mr. ZIMMER. No questions, Mr. Chairman.

Mr. SHAW. Mr. Coyne.

Mr. COYNE. No questions.

Mr. SHAW. Mr. Neal.

Mr. NEAL. No questions.

Mr. SHAW. I thank this panel and you are dismissed.

We will now recess. It looks like there are going to be two votes on the floor, so we will be gone approximately 25 minutes and then we will resume with the next panel.

We are in recess.

[Recess.]

Mr. SHAW. If everyone can be seated, we will proceed now with the next panel, which is made up of representatives from the shipbuilding and shipping industries: Thomas Jones, Jr., vice president of Atlantic Marine, and chairman of the Shipbuilders Council of America; Harvey Walpert, vice president of Trinity Marine Group, on behalf of the American Waterways Shipyard Conference; Ernest Corrado, president of the American Institute of Merchant Shipping; and H. George Miller, executive director of Shippers for Competitive Ocean Transportation, on behalf of the Coalition in Support of the OECD Agreement.

If the witnesses could all be seated at the table. You are Mr. Jones?

Mr. JONES. Yes, sir.

Mr. SHAW. They have got your names mixed up. If the staff could correct the names, it would be less confusing. Mr. Jones, we have your full statement, as we do all the witnesses, and they will be made a part of the record. Please proceed as you deem fit.

STATEMENT OF THOMAS P. JONES, JR., CHAIRMAN, SHIPBUILDERS COUNCIL OF AMERICA, ARLINGTON, VA.

Mr. JONES. Thank you, Mr. Chairman.

I am going to ask that my statement be entered in the record.

My name is Thomas P. Jones, Jr. I am chairman of the Shipbuilders Council of America, a national trade association representing American shipyards, marine equipment suppliers and naval architects. A list of our members is attached to my written statement.

These members and members of the American Waterways Operators and American Waterways Shipyard Conference who also support this Agreement represent the vast majority of U.S. shipyards who are capable of producing and repairing ships covered by this Agreement. Together, we employ 40,000 to 50,000 shipyard workers.

If this Agreement is approved, we have the potential to add tens of thousands of new jobs to the U.S. economy, jobs that have not existed in this economy for the last 30 to 40 years. Therefore, I appreciate the opportunity to appear before this subcommittee today and express strong support of these shipyards for the trade agreement on shipbuilding and ship repair subsidies and injurious pricing negotiated under the auspices of the OECD.

First of all, Mr. Chairman, I want to convey our industry's appreciation of the longstanding support by this subcommittee for our effort to eliminate foreign subsidy practices which have kept us from the international shipbuilding marketplace. Under then-Chairman Sam Gibbons, we enjoyed strong bipartisan support on this issue, and we hope that this subcommittee's commitment to fair free trade unhindered by subsidies and injurious pricing will continue.

In fact, without the leadership of Mr. Gibbons and the support of this subcommittee, we would not have an agreement today. The industry owes all of you a great debt of gratitude. We firmly believe that if Congress does not implement this Agreement by passing the enabling legislation during calendar year 1995, we will continue to face unfair foreign competition for years to come.

This Agreement is, first and foremost, a fair trade Agreement. The international shipbuilding market is replete with distortive trade practices which disadvantage U.S. yards. This Agreement eliminates those practices and offers us opportunity. Our industry, unlike most others in the United States, has had no access to antidumping and countervailing duty laws.

This Agreement provides for the first time tools for the United States to act against unfair trade practices in the commercial shipbuilding and ship repair industries. The Agreement eliminates direct and indirect subsidies benefiting ship construction and repair yards. It effectively deals with excess capacity by prohibiting dumping and subsidization of capacity, expansion and bailout. It provides for an effective disputes settlement mechanism. It is effective for all parties on January 1, 1996. It requires no changes in the

Jones Act. It does not affect naval shipbuilding, repair or modernization.

At the same time as it becomes effective on January 1, 1996, the standstill provision protects the U.S. title XI loan guarantee advantage for approximately 1½ years. The United States sought this Agreement. Reopening these negotiations, as some have suggested, would confer a huge loss in U.S. credibility and would likely result in a less favorable agreement. Failure to implement the Agreement means continued chaos in the international shipbuilding marketplace, a subsidy war and a decline of U.S. shipyards.

This Agreement will allow U.S. shipyards to become players in the international shipbuilding marketplace for the first time in almost 40 years. Tens of thousands of new U.S. jobs will be created at no cost to the taxpayer. There are no realistic alternatives to this Agreement that can produce such results.

We urge you to swiftly pass the implementing legislation so that we, the shipbuilders, can begin to fulfill our part of the bargain by producing ships for the world market.

Thank you, Mr. Chairman.

[The prepared statement and attachment follow:]

Statement By
Thomas P. Jones, Jr., Chairman
Shipbuilders Council of America
Before the
Subcommittee on Trade
Committee on Ways and Means
United States House of Representatives
on the
OECD Agreement on
Shipbuilding and Ship Repair
1100 Longworth House Office Building
Washington, DC 20515
July 18, 1995

Mr. Chairman, members of the Subcommittee, my name is Thomas P. Jones, Jr. I am Chairman of the Shipbuilders Council of America, the national trade association representing American shipyards, marine equipment suppliers and naval architects.

I appreciate the opportunity to appear before this subcommittee today to express the strong support of the vast majority of American shipyards for the trade agreement on shipbuilding and ship repair subsidies and injurious pricing negotiated under the auspices of the Organization for Economic Cooperation and Development (OECD).

First of all Mr. Chairman, I want to convey our industry's appreciation of the long-standing support by this subcommittee for our effort to eliminate the foreign subsidy practices which have kept us from the international shipbuilding marketplace. Under then-Chairman Sam Gibbons we enjoyed strong bi-partisan support on this issue and we hope that this subcommittee's commitment to fair and free trade, unhindered by subsidies and injurious pricing, will continue. In fact, without the leadership of Mr. Gibbons and the support of this subcommittee, we would not have an agreement today. This industry owes all of you a great debt of gratitude. We firmly believe that if the Congress does not implement this agreement by passing the enabling legislation during calendar year 1995, we will continue to face unfair foreign competition for years to come.

It has been six years since the Shipbuilders Council of America first filed the Section 301 trade petition with the U.S. Trade Representative which led to the OECD negotiations.

American shipyards are an integral part of our country's critical manufacturing industrial base. Ship construction represents one of the most difficult and complex manufacturing processes in the world. Because it requires many kinds and levels of expertise, it provides high paying work for every socio-economic segment of our society, including entry-level jobs for relatively unskilled urban workers, jobs for skilled industrial workers, and high-technology jobs for degreed engineers.

Furthermore, shipbuilding provides a market stimulus for other basic industries. This is because a ship is a small floating city, requiring both large and small sizes of engines, generators, motors, pumps, valves, winches, and electrical control equipment, in addition to electrical cable, electronic navigation equipment, radios, and, of course, very large quantities of piping and steel plate. This is why, for every job in an American shipyard, another five jobs are created elsewhere in the economy. In other words, America's shipyards are good for the long-term economic well-being of the country, as well as essential for ensuring that the United States has the necessary shipbuilding skills and facilities available to meet our country's defense requirements as they arise in the future.

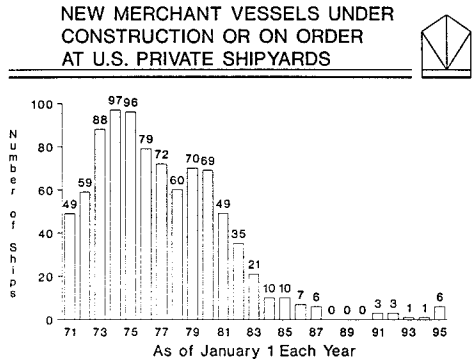
Since the passage of the Merchant Marine Act of 1936, U.S. ship operators, seagoing unions and U.S. shipbuilders were tied together in an interlocking web of government subsidies. Ships were built for U.S. operators in the foreign trades using Construction Differential Subsidies (CDS) which in later years amounted to as much as 50 percent of the cost of the ship. The ship operators also received subsidies for ship operations referred to as Operating Differential Subsidies (ODS) which included crew wages. Thus, U.S. mariners became the world's highest paid merchant seamen.

From 1955 through 1990, U.S. shipyards delivered an average of 20 ships per year. With minor exceptions, these ships were built for the U.S. Jones Act trades (55%) and for U.S. operators in the overseas trades receiving CDS (45%). Very few ships were built for foreign

owners. The recent Newport News contract to build product tankers for a Greek owner and the Alabama Shipyard, Inc. contract to construct three chemical carriers for a Danish owner are the first large offshore sales in this industry in almost 40 years. However, during this period a large number of smaller vessels have been sold competitively overseas.

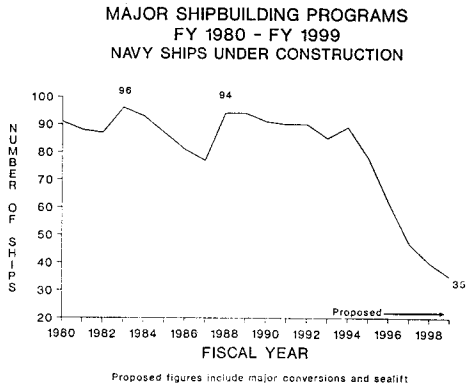
With the termination of subsidies to U.S. shipyards in 1981, the building program for overseas operators came to a halt. At the same time, U.S. Jones act operators came to believe that the Jones Act would soon be compromised so those orders slowed precipitously as well. It is unfortunate that U.S. shipyards did not take advantage of the many years of CDS subsidies to improve their productivity to permit international competition.

The chart below shows the decline in merchant construction in U.S. shipyards from the Nixon buildup in the early 1970s until the present:



Fortunately for U.S. shipyards, the demise of commercial shipbuilding coincided with the Reagan defense buildup and the goal to increase the U.S. Navy from about 475 ships under President Carter to a 600-ship Navy. This buildup sustained a large segment of the industry through much of the 1980's but as the Cold War drew to a close, the size of the industry collapsed to the point that the six largest shipbuilders in the country now control almost 95% of the dollar value of Navy shipbuilding contracts. Even though the Navy market has now declined sharply because of the down sized goal of a 345-ship fleet, each of those six shipyards measure billion-dollar backlogs or more, higher than any other shipyards in the world. Nevertheless, the Navy market will not support all of these yards in the future. Whether they acknowledge it or not, they too will need a commercial market free of subsidies and dumping. The reality is with or without the OECD Agreement, employment in the big six yards is going to decrease.

The next chart shows the precipitous decline in Navy shipbuilding backlog which is now in progress:



While the six biggest yards in the country have concentrated on Naval shipbuilding, the medium and small yards have moved toward the commercial marketplace and have become internationally competitive in many markets. These yards, honed by competition, are ready to expand their international markets and compete without subsidies based on the present agreement. We conservatively estimate that the annual commercial sales of these yards now average well over half a billion dollars per year.

As noted before, the U.S. shipbuilding industry lost its commercial subsidies in 1981, with the termination of the CDS program. Unfortunately, the timing could not have been worse. In 1981, international commercial shipbuilding entered its worst market depression in history and governments in all major shipbuilding countries, with the exception of the United States, began escalating aid programs for their yards.

By propping up their shipbuilding industries in the 1980s through subsidies and other means, foreign governments not only prevented unsubsidized U.S. yards from competing, they encouraged the dumping of ships on an unprecedented scale. At the lowest point, Asian and European shipyards were selling ships on the international market at barely half their production costs.

As a result of our inability to compete in the international marketplace because of foreign subsidies, the Shipbuilders Council of America filed a section 301 petition with the U.S. Trade Representative in 1989 charging Germany, Japan, Korea and Norway with unfair trade practices in shipbuilding and ship repair. USTR acknowledged the merits of SCA's petition but requested that we withdraw it to allow USTR to pursue multi-lateral negotiations under the aegis of the OECD. It is those negotiations which have led us here today. It should be noted that those yards which today oppose the agreement were, from 1989 through December 1994, not only members of the SCA but provided the chairmen of our Board of Directors for most of that period.

It is important to make clear that the SCA never considered that a trade agreement alone would solve the problems of the U.S. shipbuilding industry which had been shut out of the commercial market since the early 1980s, largely because of foreign subsidies. In fact, SCA's objective of getting the U.S. Government to bring an end to international commercial shipbuilding subsidies was conceived as part of an integrated plan to help U.S. shipbuilders become competitive in the international commercial market.

This integrated plan, known as the Shipyard Recovery Program, called for a partnership between government and industry. One element dealt with foreign subsidies. The other elements were concerned with implementation of a sealift ship construction program to help meet the nation's shortfall in sealift capability and at the same time provide needed workload for U.S. yards; a shipbuilding loan guarantee program to help offset the advantages of foreign shipbuilders with access to entrenched government-subsidized ship financing programs; and a shipbuilding research and development program.

The sealift ship construction program was realized first, during the Bush Administration. Title XI ship loan guarantees and the Maritech R & D grants program became part of the Clinton Administration's Shipyard Revitalization Program, which is currently being implemented. The Bush Administration instigated the OECD trade talks on shipbuilding subsidies, which were continued and brought to closure during the Clinton Administration.

SCA's Section 301 petition was an eyeopener to those inclined to doubt the enormity of foreign shipbuilding subsidies and their ability to shut U.S. yards out of the commercial shipbuilding market. Let me give you an idea of the size of government-supported shipbuilding aid among six of the world's leading shipbuilding countries -- Japan, South Korea, Germany, Italy France and Spain -- which together control approximately 85% of the world shipbuilding production. The following chart shows SCA's estimate of the annual average shipbuilding aid for Japan, Korea and four of the largest European shipbuilding countries. This data is effective for the period 1988 through 1993.

AVERAGE ANNUAL SHIPBUILDING AID BUDGETS OF TOP SUBSIDIZING OECD NATIONS SINCE 1988

Country	Ship Financing		Direct Yard Aid			R&D	Annual Average*
	Loans, Subsidized Interest	Guarantees	Contract Grants	Shipyard Capital*	Yard Loans, Interest Sub.		
S. KOREA	YES $1.8b	YES	Unknown	YES	YES $595m	YES	$2.4B
GERMANY	YES $1.5b	YES	YES $353m	YES $363m	YES Amt. unkwn	YES	$2.3B
JAPAN	YES $818m	YES	SOME	YES $85m	YES	YES $1b	$1.9B
ITALY	YES $557m	Unknown	YES $175m	YES $184m	Unknown	YES $24m	$940M
SPAIN	YES $306m	YES	YES $153.5m	YES $438m	YES	YES	$897M
FRANCE	YES $399m	YES	YES $149m	YES $83m	Unknown	YES $3m	$634M

Excludes sums and subsidy values of government guarantees.

The chart shows that, on average, shipyards in these countries received $9 billion dollars a year. Clearly, we could not compete in such a market.

I have heard the OECD Agreement criticized for not addressing the capacity expansion issue. By way of background, the South Koreans are expanding their shipyards in a move to capture greater market share. In a nutshell, they want to take business away from Japan, as they did during the market depression of the 1980s, when they combined capacity expansion with ship dumping. Since the health of the commercial shipbuilding market overall is dependent on an advantageous supply/demand balance, the Korean expansion is seen as irresponsible.

Nevertheless, the OECD Agreement is concerned with the subsidizing behavior of governments, not the behavior of private industry, no matter how reckless. Moreover, U.S. Government involvement in restraining market capacity would be questionable because of U.S. antitrust policies. Therefore, capacity expansion is an inappropriate subject for the OECD Agreement. However, this does not mean that Working Party Six, the shipbuilding section of the OECD, cannot discourage the Koreans or closely monitor their pricing behavior and that of Korean Government Banks. Of course, this can be accomplished only if the OECD Agreement goes into effect.

OECD members are also concerned that the expanding shipbuilding industries in China, India, Poland and other emerging nations will upset market discipline. The most effective way to deal with this problem is to ratify this agreement now and urge U.S. government action, in concert with the OECD, to bring these countries into the agreement.

Let me now discuss the jobs impact of this agreement. Based on the latest figures available from the OECD, there were 128,000 shipyard and sub-contractor personnel directly involved in ship construction in Japan and Korea in 1994. Those two countries in 1994 accounted for 65 percent of all commercial shipbuilding in the world so that it would be easy to draw a conclusion that only 2,000 workers are required to produce one percent of the world's ships in any year. We believe these figures are slightly understated and that a more realistic number is about 3,500 to 4,000 workers per percentage point of total production. Thus, if the United States can, over the next three to four years, capture even a very modest five percent of world shipbuilding, we will create or save 20,000 shipyard jobs and, using the 5x multiplier for jobs throughout the economy, create 100,000 jobs in the United States.

If the OECD Agreement is implemented, U.S. commercial shipbuilders will be able to take advantage of seven favorable factors:

1. Average U.S. hourly labor costs for shipyard workers are significantly lower than in Japan and Europe, which account for over 50% of world shipbuilding orders. Labor costs in Korea - another 25% or the market -- are rapidly approaching those in the U.S.

2. Since 1989 when the OECD negotiations began, the Yen, the Deutchmark and the Korean Won have all appreciated greatly -- U.S. exports now cost significantly less in real dollar terms.

3. Extensive subsidies have led to inefficient production practices in certain major shipbuilding countries at the same time that, in the absence of subsidies, some U.S. shipbuilders are dramatically improving their productivity rates and competitiveness.

4. International trade is increasing faster than worldwide industrial production, creating a need for more ships as the world continues to internationalize the marketplace.

5. The Agreement fully protects the Jones Act and allows continuation in modified form of Title XI guarantees and the Maritech Program.

6. The Agreement will cover 80% of global ship production, creating an incentive for the rest of the shipbuilding world to sign on.

7. The Agreement provides an extremely strong enforcement mechanism to discipline unfair subsidy and injurious pricing practices.

Now let me give you a few examples of what is likely to happen if the United States does not ratify the OECD Agreement. First of all, international shipbuilding subsidies will clearly continue, perhaps even escalate again. Second, there will be no controls on ship dumping behavior on the part of South Korea and others. Third, as long as the OECD countries cannot ratify an agreement to end their shipbuilding subsidies, why would non-OECD countries? Fourth, there will be far less transparency in the amounts and kind of government subsidies and injurious pricing behavior. The combination of all of these factors will leave U.S. shipyards that genuinely want to build commercial ships in a worse position than they are today. For example, in the unlikely event that the U.S. Government were willing to reverse its anti-subsidy policies of the past 14 years, our budget crisis will not allow us to provide sufficient funds to match the subsidies of foreign governments. We will lose a subsidy war - a subsidy war will escalate foreign subsidies. Therefore, U.S. yards will be rendered less competitive (not more) than we were before U.S. subsidies. Finally, the United States will lose credibility. After all, it was the United States that initiated the OECD shipbuilding talks, at the behest of the U.S. shipbuilding industry. It is improbable that the U.S. would be taken seriously should the Government ever want to instigate shipbuilding negotiations again. Thus, our government's credibility is at stake. Furthermore, if the U.S. Congress does not ratify the Agreement, how likely would the U.S. Government be to continue to aggressively represent the U.S. shipbuilding industry within Working Party Six -- the OECD body charged with international shipbuilding matters? The United States was not even a member of the working party until the Shipbuilders Council of America filed its Section 301 trade petition, thereby signalling that the U.S. shipbuilding industry was serious about wanting an end to subsidies so that it could penetrate the international market.

Let me emphasize that the OECD Agreement is about commercial shipbuilding, not about naval shipbuilding. In fact, naval ships are excluded from the Agreement. The OECD Agreement is therefore not oriented toward yards that want to continue to depend primarily on Navy business, and only dabble in the commercial market every now and then when Navy business is slow.

The OECD Agreement is for U.S. shipyards that recognize the need for an industry-government partnership to help overcome the effects of foreign subsidies, but are not looking for government handouts. It is for those of us who are serious about becoming competitive in the international commercial market. For us, the OECD Agreement is a good trade agreement. In fact, it may be the toughest, most practical industry-specific trade agreement ever. There simply are no realistic alternatives to the trade agreement and we urge your support for this important legislation. We have always envisioned this as a government/industry cooperative effort and we look forward to working with the Congress and the Administration to ensure that the implementing legislation is forceful and effective.

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July 1995

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Bay Shipbuilding Company
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Port Arthur, TX
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ASSOCIATION MEMBER

South Tidewater Association
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Mr. SHAW. Thank you, Mr. Jones.
Mr. Walpert.

STATEMENT OF HARVEY WALPERT, SENIOR VICE PRESIDENT, TRINITY MARINE GROUP, GULFPORT, MISS., ON BEHALF OF THE AMERICAN WATERWAYS SHIPYARD CONFERENCE, AND THE AMERICAN WATERWAYS OPERATORS, ARLINGTON, VA.

Mr. WALPERT. Thank you, Mr. Chairman.

This is a summary of my remarks. My full written remarks are submitted for the record.

Mr. Chairman and members of the Trade Subcommittee, I want to thank you for the opportunity to testify in support of the OECD Shipbuilding Agreement. My name is Harvey Walpert, senior vice president of Trinity Marine Group and the immediate past chairman of AWSC, the American Waterways Shipyard Conference.

I appear today on behalf of the American Waterways Operators and the American Waterways Shipyard Conference. AWO is a national trade association representing the inland and coastal barge and towing industry. Its members haul commodities, dry and liquid, on both the inland river system and along America's coastlines. A large portion of this cargo, especially grain and coal, is bound for export.

AWSC, a conference of American waterways operators, is the national trade association of U.S. second-tier small- and medium-size shipyards. AWSC members build and repair steel and aluminum hulled vessels up to 450 feet in length. This includes a wide and diverse range of vessels, towboats, tugboats, barges and a host of workboats. Some second-tier shipyards also have been successful in building these types of vessels for export to foreign customers in the international shipbuilding market.

Mr. Chairman, I believe that AWO and AWSC bring a truly unique perspective to the debate on the OECD Shipbuilding Agreement. AWO is comprised of both U.S. flag carrier companies and U.S. shipyards that build and service their vessels. The objectives which unite these sometimes diverse interests are the effective promotion of U.S. maritime industry and the stalwart—let me repeat, stalwart—support of the Jones Act.

Knowing that the proposed agreement might have had an adverse effect on the Jones Act, as well as the overall health of the U.S. maritime industry, AWO formed a task force of carrier and shipyard companies with a mandate to study the Agreement, assess its impact on the Jones Act and the domestic maritime industry, and make policy recommendations to the AWO board of directors. Because some have contended that the Agreement weakens the Jones Act, you can understand why we were especially attentive to these provisions.

The task force completed its study of the Agreement in January 1995 and reported its findings to the AWO board of directors. The conclusions of the carrier shipyard task force are as follows: The Agreement creates a level playingfield in the international shipbuilding market. The U.S. maritime industry is better off with the Agreement than without it. It reaffirms U.S. policy with regard to the continued integrity of the Jones Act. The task force recommended, and the AWO board of directors adopted, a policy posi-

tion in support of the OECD Agreement. Thus, the carrier and shipyard companies directly interested in the continued carriage of Jones Act cargo and U.S. flag vessels fully endorse this Agreement.

The OECD Shipbuilding Agreement allows U.S. shipyards to do what they do best, and that is compete. Unfortunately, foreign government subsidies, as we have heard from Mr. Gibbons and others, have disadvantaged the U.S. commercial shipbuilding business. In the face of government subsidies, U.S. shipyards, in spite of their efficiencies and the relative cost and quality of their products, are artificially denied important market opportunities. The OECD Agreement will dramatically change this unfair situation.

Mr. Chairman, it is important to note that U.S. shipyards are in a period of great opportunity. The value of the U.S. dollar in comparison to foreign currencies makes U.S. products more price competitive. This factor, combined with our overall competitive strength, will bring us great success in a subsidy-free environment. The OECD Agreement makes that possible.

The Agreement gives signatory nations two very effective tools: First, it contains a tough, effective, injurious pricing code otherwise known as the antidumping provision; and second, the Agreement establishes a binding and fair disputes resolution mechanism.

I wish to point out that a strategy built on providing cash subsidies is not feasible. First, the United States does not have the financial resources to match the large amount of subsidies already provided the foreign shipyards by their governments. Subsidies do not address the critical necessity of fundamentally improving our ability to compete.

Last, Mr. Chairman, I want to raise a caution about the suggestion of putting aside the current version of the OECD Agreement and reopening the negotiations in hopes of obtaining a new agreement that allows the United States to subsidize shipyards.

I appreciate your consideration of our views on this most important trade agreement, and I thank you for the chance to address the subcommittee. I will be happy to take any questions.

[The prepared statement follows:]

TESTIMONY OF HARVEY WALPERT
AMERICAN WATERWAYS SHIPYARD CONFERENCE, AND
AMERICAN WATERWAYS OPERATORS

Mr. Chairman and members of the Trade Subcommittee, I want to thank you for the opportunity to testify in support of the OECD Shipbuilding Agreement. My name is Harvey Walpert, Senior Vice President of Trinity Marine Group and Immediate Past Chairman of the American Waterways Shipyard Conference (AWSC).

I appear today on behalf of the American Waterways Operators (AWO) and the American Waterways Shipyard Conference. AWO is the national trade association representing the inland and coastal barge and towing industry. AWO members haul goods and commodities -- dry and liquid -- on both the inland river system and along America's coastlines. A large portion of this cargo, especially grain and coal, is bound for export.

AWSC, a conference of AWO, is the national trade association of U.S. second-tier -- small and medium sized -- shipyards. AWSC members build and repair steel and aluminum hull vessels up to 450 feet in length. This includes a wide and diverse range of vessels: towboats, tugboats, barges and a host of other workboats, fishing vessels, offshore oil industry service vessels, oceanographic and seismic research vessels, passenger ferries and small cruise vessels, harbor patrol boats, and patrol boats and landing craft for the Navy, Coast Guard and Army. Some second-tier shipyards have also had success in building these types of vessels for export to foreign customers in the international shipbuilding market.

Mr. Chairman, I believe that AWO and AWSC bring a truly unique perspective to the debate on the OECD Shipbuilding Agreement. AWO is comprised of both U.S. flag carrier companies and the U.S. shipyards that build and service their vessels. The objectives which unite these sometimes diverse interests are the effective promotion of the U.S. maritime industry and the stalwart support of the Jones Act. Knowing that the proposed agreement might have had an adverse impact on the Jones Act, as well as the overall health of the U.S. maritime industry, AWO formed a task force of carrier and shipyard companies with the mandate to study the agreement, assess its impact on the Jones Act and the domestic maritime

industry, and make policy recommendations to AWO's Board of Directors. The task force thoroughly studied the agreement and engaged in an extensive discussion on its provisions, especially on its potential impact on the Jones Act. Because some have contended that the agreement weakens the Jones Act, you can understand why we were especially attentive to those provisions.

The task force completed its study of the agreement in January 1995 and reported its findings to the AWO Board of Directors. The conclusions of the carrier-shipyard task force are as follows:

1. The agreement creates a level playing field in the international shipbuilding market.
2. The U.S. maritime industry is better off with the agreement than without it.
3. It reaffirms U.S. policy with regard to the continued integrity of the Jones Act.

The task force recommended, and the AWO Board of Directors adopted, a policy position in support of the OECD agreement. Thus, the carrier and shipyard companies directly interested in the continued carriage of Jones Act cargo in U.S.-flag vessels fully endorse the agreement.

The OECD Shipbuilding Agreement allows U.S. shipyards to do what they do best -- compete. U.S. second-tier shipyards have emerged from a severe depression in the 1980's. They are lean, efficient and ready to meet the needs of the commercial shipbuilding market. U.S. shipyards are now competitive with most international competitors in labor cost, quality and innovation. Unfortunately, foreign governments subsidies continue to give foreign shipyards an advantage in the commercial market. In the face of government subsidies, U.S. shipyards, in spite of their efficiencies and the relative cost and quality of their products, are artificially denied important market opportunities. The OECD Agreement will dramatically change this unfair situation.

Mr. Chairman, it is important to note that U.S. shipyards are in period of great opportunity. The value of the U.S. dollar in comparison to foreign currencies makes U.S. products more price

competitive. This factor, combined with our overall competitive strength, will bring us great success in a subsidy-free environment. The OECD Agreement makes that possible.

In bringing about fair and open competition and ending all direct and indirect subsidies, the agreement gives signatory nations which do not subsidize their shipyards two very effective tools. First, the agreement contains a tough, effective injurious pricing code, otherwise known as the "anti-dumping" provision. A unfair practice in international competition for shipbuilding, as well as a host of other products, is selling finished products at prices below the cost of production for the purpose of obtaining market dominance. The OECD Agreement imposes a strong and enforceable "anti-dumping" mechanism that will end this practice.

Second, the agreement establishes a binding and fair dispute resolution mechanism. An important consideration in evaluating this agreement is whether or not it is enforceable and binding on all parties. It is counter-productive for the U.S. to adhere to an agreement that is not binding on our foreign trading partners. This agreement puts into place a process that gives U.S. shipyards the opportunity to obtain quick and effective action in response to any violations.

I want to briefly draw your attention to a set of actions undertaken at the federal level that seek to boost the competitive ability of U.S. shipyards. The Administration's shipyard initiative includes the negotiation of an international agreement on shipbuilding, the Title XI Loan Guarantee Program, the MARITECH program, marketing assistance and reform of maritime related regulations. This package helps U.S. shipyards compete in the international market, but it does not provide direct cash payments of any kind. Those U.S. shipyards that are financially stable and have invested in the equipment necessary to compete in the worldwide shipbuilding market want the chance to compete in an open, subsidy-free market. Given an equal chance, U.S. shipyards will prosper and help sustain the economic growth necessary to create jobs and opportunity for U.S. workers.

I wish to point out that a strategy built on providing cash subsidies is not feasible. First, the U.S. does not have the financial resources to match the large amount of subsidies provided to foreign shipyards by their governments. Second, subsidies do not address the critical necessity of fundamentally improving our ability to compete. Subsidies do not force us to make improvements in elements such as labor cost, material handling, design and management, and innovation.

Lastly, Mr. Chairman, I want to raise a word of caution about the suggestion of putting aside the current version of the OECD Shipbuilding Agreement and reopening the negotiations in hopes of obtaining a new agreement that allows the U.S. to subsidize shipyards. That strategy is dangerous, counter-productive for U.S. commercial interests and destined to fail. In the unlikely event the parties to the negotiations agree to come back to the negotiation table, foreign nations will attempt to extract a very high price for a new agreement -- a price the U.S. will be unwilling to pay. In effect, there will be no agreement. This will tragically preclude U.S. shipyards from competing in an open and fair international marketplace. Consequently, the jobs and economic growth that would be created by expanded international market opportunities as a result of the OECD agreement will simply never happen.

Mr. Chairman and members of the Subcommittee, the United States is a maritime nation. Ever since the early days of the Republic, vessels of all types and sizes have played a key role in the economic development and military history of our nation, and as a result, the free world. This heritage must continue for a variety of important reasons. Simultaneously, the U.S. has been a builder of mighty and reliable vessels serving the military and commercial sectors of our economy. I have no doubt that given the opportunity to work in an open and fair marketplace, U.S. shipyards will once again be a leader among the world's shipbuilding nations. All we want is the chance to compete and succeed.

I appreciate your consideration of our views on this most important trade agreement and I thank you again for the chance to address the Subcommittee. I will be happy to take any questions you have.

Mr. SHAW. Thank you, Mr. Walpert.
Mr. Corrado.

STATEMENT OF ERNEST J. CORRADO, PRESIDENT, AMERICAN INSTITUTE OF MERCHANT SHIPPING, WASHINGTON, D.C.

Mr. CORRADO. Thank you, Mr. Chairman.

I would submit my statement for the record, please. I am Ernest J. Corrado, president of the American Institute of Merchant Shipping. We represent wet and dry bulk carriers in the domestic trade, Jones Act carriers. We also represent liner vessels in the international trade of the United States, and we represent three companies with vessels on charter to the Military Sealift Command. I am also cochairman of the Coalition in Support of the OECD Agreement, and I would point out, Mr. Chairman, that this coalition covers a broad spectrum of the maritime industry, comprising shippers, ports, bulk and liner carriers and shipyards, my colleagues here on my right.

We are very much in support of a strong shipyard capability in the United States. We understand the absolute necessity of a shipyard industrial base, both from the standpoint of national security and the commerce of the United States. The problem confronting us is how do we keep from losing any more and how do we build on what we have got.

As I see it, there are three ways. One is subsidy, one is unilateral action, and the third is the OECD Agreement. Mr. Chairman, I was chief counsel of the Merchant Marine and Fisheries Committee for many years, and prior to passage of the Merchant Marine Act of 1970, the 50 percent construction differential subsidy was raised to 55 percent and then 60 percent, which was really an inordinate amount of subsidy. Then in the 1970 act—and this shows I have been around almost as long as Mr. Gibbons—in the 1970's act, we put a schedule in that, which was to reduce the subsidies down to 37.5 percent over about 6 years. Obviously, of course, that did not work, so we went back to the 50 percent subsidy again until the Reagan administration eliminated it in 1982.

As has been said earlier, and I think I have some feel for this institution, I cannot believe that when the Congress is cutting Medicare and cutting agricultural subsidies and cutting school lunch programs, I cannot believe there is going to be any kind of substantial subsidy program for the shipyards or for anything else like that.

The second device, unilateral action, we struggled with for 4 years, the Gibbons bill and the Breaux bill. For all that time, I was chairman of a coalition opposed to the Gibbons bill and opposed to the Breaux bill, and we spent an awful lot of time and effort and energy over those 4 years working on that. I would say probably the one positive element of that was that the Gibbons and Breaux bills probably were quite a lever on the OECD negotiations in Paris to move them to this Agreement.

We do not believe that unilateral action is the key to this problem, and we believe that the key really is the OECD Agreement. Unilateral action, despite all the time we spent, it became pretty clear that that was not the answer to the problem. It was full of

sound and fury, but outside of being a lever in the negotiations, I do not think it really helped.

The OECD Agreement—and I participated in some of the negotiations in Paris and had a staffperson also participate—it seems clear that the U.S.-negotiators really did a fine job and it seems to be the best device that we have got in order get some parity in worldwide shipbuilding.

The carriers support the OECD Agreement because, for one thing, it eliminates the 50 percent ad valorem duty on equipment and repairs in foreign yards. We have struggled under that yoke for many years and it really is not fair. Our foreign competitors do not have any such burden and there are many, many foreign flag vessels being repaired in U.S. yards now, so it certainly is inequitable. The U.S. flag fleet, along with the shipyards, are in danger of extinction. The flag fleet is disappearing before our very eyes.

We have noncompetitive features imposed on us that our foreign flag competitors do not have. We have regulations by the Coast Guard on foreign flag vessels which are much less stringent than on U.S. flag vessels. It really does not make any sense. For 15 years, we have been trying to get the radio officers off our U.S. flag vessels, because there is a modern global maritime distress system (GMDS) now, and you do not need a guy tapping the key. The Navy no longer has them or monitors the band, nor does the Coast Guard.

So you couple that with another burden like the 50 percent ad valorem duty, Mr. Chairman, and it is easy to see why U.S. flag operators are considering and are reflagging, going to foreign flags. And unless these competitive factors are made level or equal, if you will, we are going to end up with very few U.S. flag vessels.

Another feature that we like in the OECD Agreement is the capital construction fund (CCF) which permits operators and yards to replace U.S. flag tonnage, and that is a deferred tax device and it is recouped on taxes after the vessel begins operating. We would only ask one thing. We would urge that the United States build requirement in CCF be eliminated in the implementing legislation.

As mentioned earlier, we have a lot of Jones Act operators in our organization, and many people probably think we are not too bright, but we certainly would not support the OECD Agreement if we thought it was inimical to the Jones Act. And we do not think that there is any cap on the Jones Act under these provisions. We do not think there is any uncertainty. We know very well that the goal of the foreign negotiators in OECD was to eliminate the Jones Act. That is what they were really after and that is one thing they want, because obviously they can come into our trades then and we would find it very difficult if not impossible to compete with them.

So we feel that the negotiators did a fine job in Paris, especially with respect to the Jones Act. They did not do anything to jeopardize the Jones Act. As I say, there is no cap, there is no uncertainty, there is no change in the language, and we think they really did a good job. We think that the OECD Agreement should be implemented, because the United States was the foremost proponent of this Agreement. We pushed it hard, and it would be unseemly before the world now for the United States not to ratify the Agree-

ment. We are very influential in this and the other countries will follow our lead.

If we do not do it, the other nations are going to seize the opportunity not to cooperate and not ratify this Agreement, and we certainly do not believe that renegotiating is an answer. If we go back and renegotiate, Mr. Chairman, they are all going to go south as fast as they can. They would like nothing better than to get out of this. As Mr. Gibbons pointed out earlier, it is very beneficial to us and not so beneficial to them.

For these reasons, we hope that the committee and the Congress will implement the OECD Agreement with dispatch.

I would be happy to answer any questions, Mr. Chairman. Thank you, sir.

[The prepared statement and attachments follow:]

STATEMENT OF
ERNEST J. CORRADO
PRESIDENT
OF THE
AMERICAN INSTITUTE OF MERCHANT SHIPPING (AIMS)
BEFORE THE
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE
ON
ORGANIZATION FOR ECONOMIC COOPERATION
AND
DEVELOPMENT AGREEMENT ON COMMERCIAL SHIPBUILDING SUBSIDIES
JULY 18, 1995

INTRODUCTION

I am Ernest J. Corrado, President of the American Institute of Merchant Shipping (AIMS). Thank you for this opportunity to present testimony in support of the OECD shipbuilding agreement to eliminate subsidies for commercial shipbuilding.

The American Institute of Merchant Shipping (AIMS) is a national trade association representing 23 U.S.-flag carriers which own or operate approximately eleven million deadweight tons of tankers, dry bulk carriers, containerships, and other oceangoing vessels engaged in the domestic and international trades of the United States. AIMS represents a majority of U.S.-flag tanker and liner tonnage.

I am also the Co-Chairman of the Coalition in Support of the OECD Agreement. This Coalition encompasses virtually every sector of the maritime industry including both liner and tank vessel owners and operators, shippers, ports, labor, and a majority of U.S. shipyards (with the exception of the six shipyards which recently left the Shipbuilders Council of America (SCA) to form their own group). Several members of this Coalition, including myself, personally attended the long running negotiations in Paris and participated actively in the debate over the elimination of commercial shipyard subsidies in the U.S. I can assure you that we are all vitally interested in this issue and this multilateral solution.

A list of AIMS member companies, as well as a list of organizations comprising the Coalition, is attached.

BACKGROUND OF THE AGREEMENT

One year ago, on July 17, 1994, an agreement among the key commercial shipbuilding nations was reached which, if implemented, will establish a multinational shipbuilding accord to eliminate commercial shipbuilding subsidies and other trade distortive practices. The agreement, negotiated under the auspices of the OECD, was signed by the European Union, Japan, Korea, Norway, and the United States. It applies to the construction and repair of self-propelled commercial seagoing vessels of 100 gross tons and above. The participating countries account for almost 80% of world commercial shipyard production.

The official signing of the Agreement on December 21, 1994, marked the end of nearly five years of negotiation which began in 1989 after the SCA withdrew its Sec. 301 unfair trade complaint against foreign shipbuilding subsidies in favor of pursuing a multilateral agreement.

During the long period of negotiations, two bills (H.R. 1402 by Rep. Sam Gibbons (D-FL) and S. 990 by Sen. John Breaux (D-LA)) were introduced in an attempt to expedite the international negotiations through unilateral action on the part of the United States. AIMS and the Coalition have always opposed such unilateral action on this issue and, as my testimony will explain, we believe that a multinational approach is the only reasonable method of opening worldwide commercial shipbuilding markets.

Although we have still not seen the implementing legislation, we believe the Agreement concluded by USTR is fair and more than adequate to provide for the elimination of subsidies and the enforcement of the Agreement's terms. In this regard, the OECD Agreement has four key elements:

1. Language to eliminate virtually all subsidies, direct, and indirect.
2. An injurious pricing code designed to prevent dumping in the shipbuilding industry.
3. A comprehensive discipline on government financing for exports and domestic ship sales designed to avoid trade distortive effects.
4. A dispute settlement mechanism.

The Agreement also contains a "standstill agreement" providing that the subsidy levels under existing programs will not be increased and that no new subsidy programs will be introduced while the signatory nations are implementing the Agreement. Importantly, the Agreement specifically grants the U.S. a derogation which allows it to maintain the home build provisions of the Jones Act (46 U.S.C. Sec. 883). This statute sets forth a strict U.S.

build requirement which provides U.S. shipbuilders with complete and absolute protection against imports of any foreign-made vessel for use in the domestic trade of the U.S.

DISCIPLINING COMMERCIAL SHIPBUILDING SUBSIDIES IS BEST ACHIEVED BY INTERNATIONAL AGREEMENT

The multilateral OECD agreement offers the best chance of disciplining shipbuilding subsidies worldwide. Opponents of the OECD Agreement claim that it would be better to have no agreement at all than to implement this Agreement. Although we do not claim that the OECD agreement is perfect, we do believe that implementing it would be far better for U.S. commercial shipbuilding than to maintain the status quo (heavy subsidization by competing foreign shipbuilding countries) or to attempt some type of unilateral action.

The commercial reality is that U.S.-flag operators are not building vessels for the international trade in U.S. yards for the simple reasons that it costs much more and takes much longer than overseas. Actually, it has cost significantly more to build a ship in a U.S. yard than in a foreign yard for several decades. However, until 1982 the U.S. government subsidized the difference in U.S. shipbuilding costs (up to 50% of the U.S. costs). Not surprisingly, since the elimination of this subsidy in 1982, very few U.S.-flag vessels have been built in U.S. yards for commercial operation in the international trades.

The significant cost differential is due in part to foreign shipbuilding nations subsidizing their shipyards. Without the OECD Agreement foreign subsidies will continue and the situation may worsen. In order to become competitive with their foreign counterparts in the absence of the OECD Agreement, U.S. shipyards would require massive subsidies to offset the higher U.S. construction costs and the effect of foreign subsidies. Given the current climate of Congress, under which no federal agency or program is immune from the budget axe, it is highly unlikely that any subsidy program would be funded.

The other, equally undesirable alternative is for the U.S. to attempt some kind of unilateral action. This would be disastrous. The USTR testified before this Subcommittee in March 1991 that of the available options, a multilateral agreement "is the only reasonable one ... based on a solid, rational analysis of the commercial needs of the industry." A few months later, on July 9, 1991, the then Ambassador S. Linn Williams testified before your Subcommittee on attempts by the U.S. Congress to pass legislation to address the problem unilaterally. The Ambassador stated that such action "would not be an effective means of eliminating trade distorting practices in the shipbuilding sector ... and might actually result in less favorable conditions for U.S. shipbuilders than an international agreement."

Furthermore, the multilateral OECD agreement is a far superior means of controlling shipbuilding subsidies because it will provide a uniform and structured regime. If each country were to determine individually the definition of a subsidy and the limitations on its subsidy reform, the likely result would be a chaotic and ineffective system. Moreover, it is very likely that the biggest shipbuilding nations would continue to subsidize their yards.

Clearly, of the alternatives available to assist U.S. shipyards to become more competitive, the only one politically and economically practical is the implementation of the multilateral OECD Agreement.

REPEAL OF THE 50% AD VALOREM DUTY ON FOREIGN SHIP REPAIRS

From the perspective of the owners and operators of U.S.-flag vessels, one of the most significant and beneficial results of implementing the OECD agreement will be the repeal of the 50% ad valorem duty currently levied on the cost of equipment purchased for and the repair of U.S.-flag vessels in foreign shipyards. It is no secret that the U.S.-flag fleet is in serious jeopardy. The vessel repair duty, which is only levied on U.S.-flag vessels, has burdened U.S. shipowners and trade for 120 years. The time has come to eliminate this duty. As the U.S.-flag fleet continues its spiraling decline, this onerous duty cannot be justified. U.S. operators are already burdened with many costly requirements to which their foreign-flag counterparts are not subject. U.S.-flag vessels should be able to seek repairs wherever it is most convenient and cost-effective, just as their foreign-flag counterparts do. A large number of foreign-flag vessels are now maintained and repaired in U.S. yards. It is unreasonable to continue a 50% duty on U.S.-flag vessels repaired abroad.

Although the repeal of the ad valorem duty will result in only a small loss of tax revenues, efforts are continuing to eliminate any remaining PAYGO problems. There has been some dispute about how much this loss will be, but at most the Department of Treasury estimates it will cost only $50 million over the next 5 years. We believe that this amount does not take into account the effect of the continuing and rapid decline of the U.S.-flag fleet. Only about 50% of the revenue collected in recent years is from repairs done in OECD signatory countries. In addition, the duty does not apply to Canada and is being phased out for Mexico and NAFTA.

CAPITAL CONSTRUCTION FUND (CCF)

The CCF program, set forth in Section 607 of the Merchant Marine Act of 1936, is designed to encourage construction, reconstruction, and acquisition of vessels for the U.S.-

flag fleet. U.S. operators enter into binding contracts with the government which allows them to defer income tax on amounts deposited in a CCF to be used for an approved shipbuilding program. The deferred tax is later recouped by Treasury because the tax basis of the U.S.-flag vessels purchased with the CCF funds is reduced dollar for dollar to compensate for the tax deferral. This program should be maintained. It is sorely needed by the very few U.S.-flag ships left in service.

ESTIMATE OF REVENUE IMPACT OF REPEAL OF "U.S.-BUILD" REQUIREMENT FROM CAPITAL CONSTRUCTION FUND PROVISIONS UNDER OECD SHIPBUILDING AGREEMENT

Elimination of the "U.S.-build" requirement for the CCF program will not result in a revenue loss to the government. As described below, the U.S.-flag fleet engaged in foreign commerce is shrinking dramatically due to unrelated circumstances. The repeal of the U.S.-build requirement for the CCF will not alter that trend.

U.S.-flag carriers in domestic (Jones Act) service will continue to build all vessels in the U.S. in compliance with the statutory requirement in Sec. 27 of the Shipping Act of 1920. There will be few Jones act ships constructed in the near future because the existing fleet is adequate for many years of service.

U.S.-flag vessels in export-import commerce are rapidly decreasing in number. Many liner ships are leaving service due to scrapping at the end of their useful lives. In addition, newer U.S.-flag liner ships are being reflagged to foreign registry due to competitive pressures. Sea-Land reflagged five large containerships to Marshall Islands registry during the past few months.

In addition, the three largest U.S. carriers are now bringing fifteen new containerships into service. American President Lines has built six large (4,800 TEU) new ships; Sea-Land has built five large (4,400 TEU) ships; and Lykes Bros. S.S. Co. has built four (2,480 TEU) ships. All fifteen of these newest additions to their fleets will be registered in the Marshall Islands or other foreign registry. These companies cannot justify the substantial added expense of U.S. registry for liner vessel operations. U.S. registry means higher labor costs and higher regulatory compliance costs, making U.S.-flag vessels noncompetitive with foreign competition.

The remaining U.S.-flag fleet is expected to experience added reflagging in the next few years, absent enactment and funding of a new Maritime Security Program. It does not appear likely that an appropriation for such a program will be provided for FY '96 due to the difficult schedule in the Senate and the House, and severe budgetary constraints.

U.S.-flag tankers operate mainly in the Jones Act trade and will experience a sharp drop in numbers due to the strict regulatory requirements imposed by OPA 90. Alaskan oil is declining in volume and will result in fewer tankers.

The combination of these factors will result in a sharp reduction in the size of the U.S.-flag fleet. Consequently, there will not be a revenue loss resulting from the repeal of the "U.S.-build" requirement for the CCF.

METHODOLOGY OF REVENUE ESTIMATE

The attached Chart A estimates the revenue loss of the Agreement. based upon the most currently available public information, for the years 1988-1992, the average ad valorem duty collected under the Vessel Repair Statute by the U.S. Customs Service for U.S.-flag vessels engaged in the foreign commerce of the United States was $4.36/deadweight ton. The projection reflected on the previous chart for duty collections under the Vessel Repair Statute for the years 1995-2000 was calculated by multiplying the projected deadweight tonnage of U.S.-flag vessels over the period by the average ad valorem duty per deadweight ton ($4.36) and adjusting the result downward to reflect the historical percentage (53%) of the total annual duty paid on repairs done in signatory countries.

ASSUMPTIONS AND RELATED HISTORICAL DATA EMPLOYED IN THE PROJECTION OF THE AD VALOREM DUTY TO BE COLLECTED BY CUSTOMS UNDER THE VESSEL REPAIR STATUTE FOR YEARS 1996-2000

A. The Declining U.S.-flag Fleet

The figures in Chart A relate to privately-owned U.S.-flag vessels engaged in the foreign trade of the United States (i.e., vessels that regularly operate between U.S. ports and foreign ports). U.S.-flag vessels that are laid up or which operate exclusively in the domestic trade of the United States (i.e., vessels that only operate between U.S. ports) are not included in these figures. Most U.S.-flag vessels in the domestic trade are not repaired in foreign shipyards and, as such, are not subject to the 50% foreign repair duty.

As Chart B official U.S. Navy estimate demonstrates, the U.S.-flag fleet has been declining steadily over the past 5-10 years. This decline has resulted from a variety of factors including relatively high U.S. labor costs, burdensome Coast Guard vessel and inspection standards, inequitable tax treatment of U.S.-flag operators, dwindling federal support for the U.S.-flag fleet and increasingly aggressive foreign competition. The reference in the Chart B to the "EUSC fleet" relates to the Effective-United States-Controlled fleet -- or, in other words, U.S. owned, foreign-flag vessels that are not subject to the foreign repair

duty. As the U.S.-flag liner fleet declines, the EUSC liners fleet is experiencing a corresponding increase.

Currently, 36 U.S. flag liner vessels and 27 U.S.-flag bulk vessels receive operating differential subsidy (ODS) from the U.S. Maritime Administration pursuant to long-term ODS contracts. The contracts for liner vessels will begin to terminate on December 31, 1996, and will all be terminated by December 31, 1998. The Maritime Administration has clearly stated that no new ODS contracts will be entered into after the existing agreements expire. Absent a new promotional program, most, if not all, of the U.S.-flag vessels receiving ODS will leave the U.S.-flag, resulting in a dramatic decline of U.S.-flag vessels in the 1996-97 time frame. As foreign-flag vessels, these vessels obviously will not be subject to the foreign repair duty.

A bill is pending in the House (H.R. 1350) that, if enacted, would provide, subject to annual appropriations, operating subsidies to no more than 50 U.S.-flag ships on an annual, commencing on October 1, 1995. This bill has been reported out of the House National Security Committee but has not been brought to the House floor as of yet. There is no companion bill pending in the Senate. Additionally, the House version of the FY 1995 Commerce, Justice, State Appropriations bill, which funds the Maritime Administration, includes no funding for the new program envisioned by H.R. 1350. Accordingly, "Chart A" assumes that the existing ODS program will terminate, the new program proposed in H.R. 1350 will not be enacted and funded, and that significant re-flagging of vessels currently under the U.S.-flag to foreign registry will occur in the 1996-1997 time frame. This dramatic decline in the U.S.-flag fleet will obviously create a significant downward trend in collections by the Customs Service of duty under the Vessel Repair Statute.

B. Collection Under the Vessel Repair Statute

Chart A includes the most currently available public data on the collections by the Customs Service of the foreign repair duty for the years 1988-1992. The annual duty collected has varied year by year due to a variety of factors, including the settlement in any given year of prior duty protest claims, the aging of the fleet, occasional large repair projects in foreign shipyards, the size of vessels repaired in any given year, and the non-availability of U.S. shipyards in 1991-1992 due to the repair/maintenance work done at that time on DOD vessels in connection with Desert Shield/Desert Storm.

Chart A above reflects duty paid in the years 1988-1992 by U.S.-flag carriers for foreign repairs in all foreign countries. The proposed legislation to implement the OECD Agreement on Shipbuilding would only repeal the foreign repair duty for repairs done in countries that are signatories to the OECD Agreement on Shipbuilding. Repairs in these countries have historically generated 53% of the total annual duty paid. Countries such as Singapore, China and Brazil, where significant foreign repairs are conducted are not signatories and, as such, duty for repairs in such non-signatory countries will continue to be paid -- and should not be included in a revenue estimate of the cost of the partial repeal.

In 1988, as part of the Canadian Free Trade Agreement, the duty charged under the Vessel Repair Statute for repairs on U.S.-flag vessels in Canada has been eliminated. And, in 1993, as part of NAFTA, the duty charged under the Vessel Repair Statute for repairs on U.S.-flag vessels in Mexico was reduced and is in the process of being phased out according to the following schedule: 1995: 30%; 1996: 20%; 1997: 10%; 1998 and thereafter: 0%. These changes will obviously result in lower duty receipts over the next five years from repairs to U.S.-flag vessels in Canada and Mexico.

THE JONES ACT IS NOT AFFECTED

Opponents of the Agreement continue to raise concern that the Agreement has a negative impact on the cabotage provisions of the Jones Act. The cabotage provision of the Jones Act requires vessels engaged in the coastwise trades of the U.S. to be U.S.-built, U.S.-flagged and U.S.-manned. It represents a cornerstone of U.S. maritime policy.

To our knowledge, three arguments have been raised with respect to the Jones Act:

1. that the Agreement would force a change in U.S. Jones Act law itself;
2. that the Agreement would place a cap on U.S. Jones Act production; and
3. that the Agreement will cause uncertainty in the Jones Act marketplace thereby disrupting Jones Act construction.

This is complete nonsense.

First, having participated in the OECD Agreement negotiations in Paris, I can personally confirm that the U.S. position never wavered from ensuring the complete protection of the Jones Act law. And, in fact, our negotiators achieved that goal. Under the Agreement, there is absolutely no scenario under which the U.S. would be required to change a word of the Jones Act law. What the Agreement does is to provide for the monitoring of the level of Jones Act tonnage being constructed in the U.S. with an eye toward resolving whether this U.S.-protected tonnage is distorting the global shipbuilding market.

The Agreement provides that (1) if the Jones Act tonnage exceeds a certain threshold, and (2) if an OECD party nation actually believes that this tonnage is disrupting the global market and can convince the other OECD parties of the same, then the only consequence

of the Agreement is that the aggrieved nation can impose restrictions on U.S. Jones Act shipbuilders of an equivalent nature and magnitude in their nation. There is absolutely no limit on the amount of Jones Act tonnage that may be constructed in any year. And, since future Jones Act tonnage is expected to be only on the order of 200,000 - 300,000 tons per year, while annual global construction tonnage is measured in the tens of millions of tons, the impact of such a restriction is really nil.

To the charge that the Agreement will cause uncertainty in the Jones Act marketplace, I would simply respond that we are the Jones Act market and we are among the most ardent supporters of the Agreement. The membership of AIMS, collectively with that of my colleagues from the American Waterways Operators (AWO), represent virtually the entire market for Jones Act ships. Further, I would call your attention to the shipbuilder witnesses supporting this agreement who represent nearly the entire Jones Act-related commercial shipbuilding industry. As should be made clear by the supporting witnesses here today, there is no uncertainty in the Jones Act market or supply industries concerning this Agreement.

Having been part of the negotiations, it is my belief that the Jones Act-related provisions of the Agreement represent an adequate and satisfactory compromise. In fact, the Agreement has no practical effect on the Jones Act law. This is exactly what the U.S. shipbuilding and ship operating industry orignially asked USTR to achieve.

In our opinion attacks on the Agreement based on Jones Act are frivolous arguments that represent nothing more than an attempt by the large Naval yards to obscure their true agenda which is to scuttle the Agreement so that they can convince Congress to provide those six shipyards with direct subsidies.

CONCLUSION

Implementing this long-awaited international OECD agreement offers the best chance of ensuring that operators of U.S.-flag vessels will be able to acquire and repair their vessels on the world market at internationally competitive prices -- just as their foreign competitors do. This Agreement is also widely supported by the full spectrum of the U.S. maritime community. It is the only economically and politically feasible means to eliminate commercial shipbuilding subsidies. This agreement will allow U.S. shipyards to become more competitive in the international arena. By repealing the duty on foreign ship repairs, a cost disadvantage borne by U.S.-flag vessel operators will be eliminated.

I will be happy to answer any questions you may have.

AMERICAN INSTITUTE OF MERCHANT SHIPPING
MEMBER COMPANIES

AMERADA HESS CORPORATION
AMERICAN OVERSEAS MARINE CORPORATION
AMERICAN PRESIDENT COMPANIES, LTD.
AMOCO TRANSPORT COMPANY
ARCO MARINE, INC.
BP OIL SHIPPING COMPANY, U.S.A.
CHEVRON SHIPPING COMPANY
COSCOL MARINE CORPORATION
CROWLEY MARITIME CORPORATION
FARRELL LINES INCORPORATED
HVIDE MARINE INCORPORATED
INTEROCEAN UGLAND MANAGEMENT CORPORATION
MAERSK LINE, LIMITED
MOBIL OIL CORPORATION
MORMAC MARINE TRANSPORT, INC.
OMI CORP.
OSG BULK SHIPS, INC.
PHILLIPS PETROLEUM COMPANY
SEA-LAND SERVICE, INC.
SEARIVER MARITIME, INC.
SUN TRANSPORT, INC.
TEXACO
UNOCAL -- MARINE DEPARTMENT

COALITION IN SUPPORT
OF THE
OECD SHIPBUILDING AGREEMENT

American Association of Port Authorities
American Institute of Merchant Shipping (AIMS)
American President Lines
American Waterways Operators
American Waterways Shipyard Conference
Atlantic Marine Inc.
CENSA
Central Gulf Lines, Inc.
Crowley Maritime Corporation
Federation of American Controlled Shipping
International Shipholding Corporation
Labor Management Maritime Committee
Maersk Lines
McDermott, Inc.
Shippers for Competitive Ocean Transportation
Sea-Land Service, Inc./CSX Corporation
Shipbuilders Council of America
Totem Ocean Trailer Express, Inc.
Trinity Marine
Waterman Steamship Corporation

Chart A

U.S.–FLAG DEADWEIGHT TONNAGE IN FOREIGN TRADE AND
AD VALOREM DUTY COLLECTED BY CUSTOMS
UNDER THE VESSEL REPAIR STATUTE
IN THE YEARS 1988 THROUGH 1992 AND
PROJECTED COLLECTIONS FOR YEARS 1996 THROUGH 2005

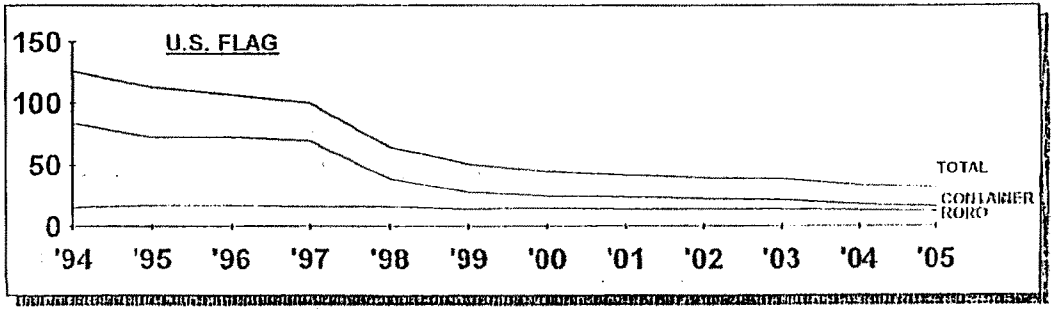
YEAR	VESSELS	DEADWEIGHT	AD VALOREM OECD ENACTED	AD VALOREM OECD NOT ENACTED
1988	126 [1]	3,948,000 [1]	$14,576,455 [2]	
1989	141 [1]	5,263,000 [1]	26,934,016 [2]	
1990	131 [1]	4,761,000 [1]	16,682,424 [3]	
1991	127 [1]	5,364,000 [1]	21,103,298 [3]	
1992	112 [1]	4,944,000 [1]	26,613,598 [3]	
1993	131 [1]	5,487,000 [1]	NOT AVAILABLE	
1994	135 [1]	5,494,000 [1]	NOT AVAILABLE	
1995	128 [1]	4,633,000 [1]	NOT AVAILABLE	
1996	82	2,968,000	6,082,000	12,940,000
1997	62	2,244,000	4,598,000	9,784,000
1998	42	1,520,000	3,115,000	6,627,000
1999	30	1,086,000	2,225,000	4,735,000
2000	30	1,086,000	2,225,000	4,735,000
2001	30	1,086,000	2,225,000	4,735,000
2002	30	1,086,000	2,225,000	4,735,000
2003	30	1,086,000	2,225,000	4,735,000
2004	30	1,086,000	2,225,000	4,735,000
2005	30	1,086,000	2,225,000	4,735,000
PROJECTED AD VALOREM FOR YEARS 1996–2000			$18,245,000 [4]	$38,821,000 [5]
PROJECTED AD VALOREM FOR YEARS 2001–2005			$11,125,000 [4]	$23,675,000 [5]
PROJECTED AD VALOREM FOR YEARS 1996–2002			$22,695,000 [4]	$48,291,000 [5]
PROJECTED AD VALOREM FOR YEARS 1996–2005			$29,370,000 [4]	$62,496,000 [5]
PROJECTED REVENUE LOSS YEARS 1996–2000			$20,576,000	
PROJECTED REVENUE LOSS YEARS 2001–2005			$12,550,000	
PROJECTED REVENUE LOSS YEARS 1996–2002			$25,596,000	
PROJECTED REVENUE LOSS YEARS 1996–2005			$33,126,000	
AVERAGE AD VALOREM PER DEADWEIGHT TON YEARS 1988–1992			$4.36	

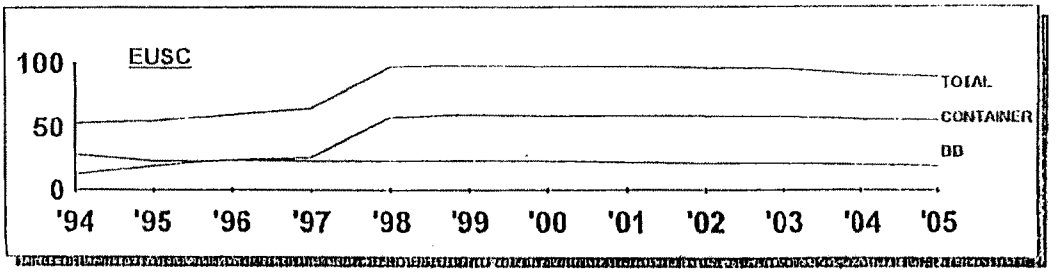
YEARS 1988 THROUGH 1995 ACTUAL DATA
YEARS 1996 THROUGH 2005 PROJECTED DATA

[1] SOURCE: MARITIME ADMINISTRATION
[2] SOURCE: CARRIER RULINGS BRANCH, U.S. CUSTOMS SERVICE
[3] SOURCE: GLOBAL TRADE TALK, MAY/JUNE 1993, U.S. CUSTOMS SERVICE
[4] ADJUSTED FOR ENACTMENT OF OECD AGREEMENT
[5] ASSUMES OECD NOT ENACTED

CHART B

U.S. FLAG/EUSC FLEET FORECAST



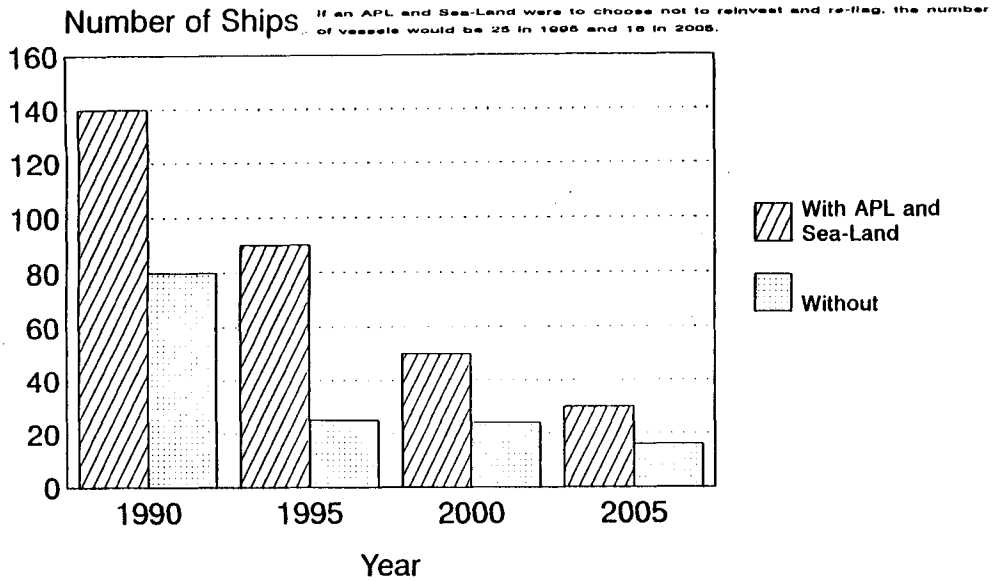


U.S. Flag Oceangoing Commercial General Cargo Fleet 1990-2005

(Assumes No Supportive Maritime Policy)

CHART C

According to the Maritime Administration, without a supportive maritime policy, by the year 1995 the commercial general cargo fleet will deteriorate to 90 vessels and to 30 by 2005 (primarily Jones Act). If an APL and Sea-Land were to choose not to reinvest and re-flag, the number of vessels would be 25 in 1995 and 15 in 2005.



Excludes dry bulk ships.

Source: Briefing by Dr. Robert Martinez, Dep. Administrator

Mr. SHAW. Thank you, Mr. Corrado.
Mr. Miller.

STATEMENT OF H. GEORGE MILLER, EXECUTIVE DIRECTOR, (SCOT) SHIPPERS FOR COMPETITIVE OCEAN TRANSPORTATION, DAMASCUS, MD.

Mr. MILLER. Thank you, Mr. Chairman, for the opportunity to present the views of U.S. exporters and importers, the users of the world fleet that are represented by SCOT. The information on who SCOT represents and why we support enactment of the legislation are covered in my written statement and I will emphasize only a few points. This will be underscoring the points that have been made much more effectively by Congressman Gibbons, Senator Breaux and others on the panels.

The Nation faces two critical economic challenges. Balancing the Federal budget is the primary challenge. Congress and the administration need to be committed to making the difficult decisions essential to accomplishing that goal. Hopefully, the voting public will support those who have the courage to make those decisions.

The second challenge is to eliminate the chronic unfavorable trade balance that increased our international indebtedness by over $1.2 trillion over the past 18 years, and caused severe devaluation of the U.S. dollar. Shippers recommend enacting this legislation because we believe it provides the only economically sound and politically feasible way to remove most of the current subsidies by foreign yards.

Three methods have been discussed to make U.S. shipyards competitive. The first is massive subsidies to offset the subsidies of other countries to modernize yards and to offset any cost disadvantage of U.S. yards. Given the need to balance the budget, we do not see new subsidies as an acceptable solution.

The second is unilateral action forcing the major shipbuilding countries to eliminate their subsidies. The proposals on unilateral solutions were made in the 102d and 103d Congresses and opposed by U.S. shippers. The proposals would have imposed high fines on vessels flagged in or owned by nationals of countries who subsidize shipbuilding. Enactment of that type of legislation would remove many vessels in the world's fleet from U.S. service and/or greatly increase the cost of freight for U.S. shippers. It would place at risk billions of dollars of U.S. exports and hundreds of thousands of jobs related to them. Shippers did and will continue to strongly oppose legislation that places U.S. exports at a disadvantage or would increase our unfavorable balance of trade. We do not believe unilateral action is an economically acceptable solution.

The final solution is a multilateral agreement under which major shipbuilding countries agree to eliminate subsidies. We believe the agreement under consideration will give efficient U.S. yards the ability to secure an increasing share of the world market for our commercial vessels. It is not only an acceptable solution, but the only one that is economically and politically viable.

We urge your prompt enactment. I will be glad to answer any questions.

Thank you very much.

[The prepared statement follows:]

COMMENTS BY SHIPPERS FOR COMPETITIVE OCEAN TRANSPORTATION (SCOT) 301 253-1910 BEFORE THE SUBCOMMITTEE ON TRADE OF THE HOUSE COMMITTEE ON WAYS AND MEANS ON THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT AGREEMENT ON SHIPBUILDING. JULY 18, 1995.

SCOT is recognized by the Maritime Administration and by the Administration's Interagency Maritime Policy Group (IMPG) as a spokesman for shippers at international maritime negotiations. SCOT's membership includes a cross section of major U.S. exporters and importers and industry associations whose members account for billions of dollars of U.S. exports. A list of SCOT members is attached.

The shippers represented by SCOT favor a free and open market for U.S. goods and services with minimum interference by governments or distortion of the free market by government subsidies. The shippers represented by SCOT strongly support the prompt enactment by Congress of the legislation necessary to implement the U.S./OECD Shipbuilding Agreement signed on December 24, 1994, hereinafter referred to as the "Agreement."

Of three possible actions by the U.S. government that have been proposed to improve the ability of U.S. shipyards to compete in the world market, only multilateral action as proposed in the Agreement would appear to be politically and economically practical.

The possible actions that have been considered are:

(a) Massive new U.S. subsidies to offset the higher U.S. construction costs and the effect of foreign subsidies. This type of subsidy was discontinued in the 1980's for U.S. flag vessels in the foreign trades because it required a subsidy of approximately 100% of the world competitive cost. Congress and the Administration have recognized the critical economic need to balance the federal budget as soon as practical. This will require much political courage and making many difficult decisions to cut programs that have some benefit to the U.S. economy or to U.S. citizens. In this climate the approval of major new shipbuilding subsidies does not seem to be an acceptable solution.

(b) A second solution proposed in 1993 and 1994, partly to put pressure on foreign countries to reach an agreement to eliminate shipyard subsidies, was for the U.S. to take unilateral action to attempt to force the major world shipbuilding nations to eliminate their subsidies. In testimony before the House and Senate Committees considering these bills, SCOT, representing U.S. shippers, strongly opposed the legislation. Enactment would have denied U.S. shippers economic access to much of the world fleet upon which we are dependent for movement of our chemicals, agricultural products, coal, fertilizers, forest and paper products, automobiles and other products to world markets. It would also significantly increase the cost to import oil and other critical raw materials and consumer goods. These actions would have increased U.S. freight rates relative to rates from the remainder of the world and would cost the U.S. economy billions of dollars of exports and hundreds of thousands or export related jobs. The U.S. has had an unfavorable trade balance for over 14 years and has increased our international debt by over $1.2 trillion. Elimination of this unfavorable balance is essential. We believe unilateral action would increase our unfavorable trade balance and is not acceptable to the U.S. economy. Shippers will continue to strongly oppose unilateral action that places U.S. exports at a disadvantage in world markets.

We do, however, recognize and appreciate that Mr. Gibbons' efforts to enact this legislation were instrumental in encouraging both the USTR and the foreign governments to finally reach the preferred multilateral solution to rationalizing the global shipbuilding market.

(c) We, therefore, believe the Agreement is the only economically viable solution that will permit efficient U.S. shipyards prompt access to the world shipbuilding market. This Agreement is a compromise hammered out over five years of intensive negotiations and in which the major world shipbuilding nations made many concessions to the U.S. negotiating team. In those negotiations it must be recognized that while smaller U.S. yards were able to compete on a few smaller specialized vessels, the U.S. had not built a single major commercial vessel for the world market for over 30 years. We do not infer that the present Agreement is perfect, but we are convinced it is a practical solution that will result in prompt and very significant progress in the needed multilateral action to eliminate many of the world subsidies. As the Shipbuilding Council of America (SCA) will testify, many U.S. yards believe they will be able to compete for increasing share of the world market if the Agreement is ified.

T e who propose to reopen these negotiations must recognize t a new agreement is likely to take years to achieve and many ne by reached. In the interim, many of the present shipbuilding subsidies will be continued. Also, having pressed for and secured many concessions in the five years of negotiations, and having accepted the present Agreement, U.S. negotiators will be at a disadvantage if we now reject that Agreement.

In Summary. U.S. shippers support multilateral action to eliminate market distorting shipyard subsidies. While this may increase the cost of vessels on the world market and result in increases in world freight rates, the U.S. shippers will continue to have access to the total world fleet on the same basis and at rates competitive with producers of the agricultural, mining and manufactured products in competitive countries. U.S. industry is confident they can compete if they have freight rates competitive with other world producers.

Having hammered out a workable, if not ideal, Agreement on shipbuilding subsidies, we believe that the interest of the U.S. economy will be best served by prompt enactment of the legislation required for the U.S. to implement the Agreement.

H. George Miller
Executive Director SCOT
(301) 253-1910

Attachment: SCOT Membership List

Mr. SHAW. Thank you, Mr. Miller.

Mr. Gibbons.

Mr. GIBBONS. No questions except to Mr. Miller and Mr. Corrado. I remember your opposition and, as I said then my strategy was to get as nasty as we could in the United States in order to get an agreement. I do not know whether that worked or not, but we are here and I am glad we are all on the same team now. I am glad to hear the strong testimony from this panel that we need to get this Agreement implemented.

Mr. CORRADO. Well, we really regretted having to oppose your bill, Mr. Gibbons, but, as you say, we are all on the same side now and I hope we will be successful. Thank you.

Mr. GIBBONS. Thank you.

Mr. SHAW. We thank each of you for testifying here before us today. We very much appreciate your testimony.

Our final panel is composed of representatives from the shipbuilding industry: Tom Bowler, president of the American Shipbuilding Association; Duane Fitzgerald, president and chief executive officer of Bath Iron Works, and president of the American Shipbuilding Association; Albert Bossier, Jr., president and chief executive officer of Avondale Industries, and vice chairman of the American Shipbuilding Association; and Gerald St. Pé, who is president of Ingalls Shipbuilding.

If the gentlemen would be seated. Mr. Bower, you will be our first witness, please. As I said to the previous panels, each of your testimonies will be made a part of the record and you may summarize as you see fit.

Mr. Bowler.

STATEMENT OF TOM BOWLER, PRESIDENT, AMERICAN SHIPBUILDING ASSOCIATION, ARLINGTON, VA.

Mr. BOWLER. Thank you, sir.

Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify on behalf of the American Shipbuilding Association, which represents the six largest shipyards in this country, employing some 95 percent of U.S. shipbuilding workers. We are testifying against the implementation of this Agreement. Even though our members supported the section 301 petition that led to these negotiations, which after 5 long years produced this Agreement last July.

I also want to thank Mr. Gibbons for his tireless efforts on behalf of our industry. If this Agreement mirrored the airtight and foreseeable legislation you sponsored, sir, it would have our unqualified support. We are in the unfortunate position, however, of opposing the Agreement, because a confluence of circumstances during the negotiations allowed our foreign competitors to secure a permanent competitive advantage in the world shipbuilding market. Those circumstances are:

First, since 1981, as Congressman Bateman said, U.S. shipbuilders have been almost exclusively building the Navy's ships that helped bring a welcome end to the cold war. But 1989 started a sharp decline in Navy budgets, culminating in the Navy ordering only three new combatant ships this year.

Second, the world commercial fleet began reaching block obsolescence in the late eighties, and the worldwide shipbuilding market for large oceangoing vessels was projected to exceed $350 billion in a 10-year period. U.S. shipbuilders, therefore, saw the early nineties as our window of opportunity to reenter commercial shipbuilding.

And, third, because of this demand for new ships, foreign shipyards had no incentive to reach an agreement quickly. The longer the negotiations continued, the more time foreign shipyards had to complete their facility modernization and fill their order books before any agreement to eliminate subsidies could affect them. This is why we firmly believe that no agreement is better than this Agreement.

I would like to summarize our specific concerns with the Agreement. Number one and most importantly, the transition terms benefit foreign shipbuilders to the detriment of U.S. shipbuilders. We stated from day one of the negotiations that foreign subsidies should be phased out at a 2-year period at most. The negotiations began in 1989, and foreign subsidies are allowed until 1999. So we effectively have a 10-year subsidy phaseout period, not a 2-year period. And, as has been mentioned before, on top of this generous subsidy phaseout period, the Agreement authorizes over $2 billion in special assistance to various countries.

Number two, construction opportunities for U.S. shipbuilders for our domestic coastwise trade could be threatened. Now, we have heard a lot here this morning about the Jones Act, and here is the Agreement and you can read page 26 and you can read page 27. Our understanding is that for shipbuilders who are engaged in both the Jones Act and are trying to penetrate the international market, this Agreement allows them to be challenged and penalized. That is what our reading of the Agreement says.

Our negotiators also completely underestimated the resiliency of U.S. shipbuilders. They inserted an unrealistic 200,000 annual ton trigger to challenge the Jones Act. Just two of our shipyards will deliver more commercial tonnage than that in 1997 alone.

Number three, the title XI loan guarantee program will be rendered ineffective. After lying dormant for 13 years, Congress strengthened the program in 1994 to make the terms more favorable and available for ship exports and shipyard modernization.

In just the past 15 months, over $800 million in loan guarantees have been approved. And this title XI program was directly responsible for one of our shipyards to win the first U.S. ship export order in this country in nearly 40 years. This is the only U.S. Government program that has created shipbuilding orders at no cost to the taxpayer if the loan is repaid. We negotiated away a real jobs producing program and received nothing in return.

Finally, we question whether this Agreement will be effective at all in eliminating foreign subsidies. My testimony for the record details our concerns regarding the Agreement's exemptions for government funded research and development, its lack of transparency to marine component manufacturers, and the difficulty of bringing and proving an injurious pricing case. Far from being airtight and enforceable, we see this as the Swiss cheese of trade agreements.

It will not stop foreign subsidies, but will do irreparable harm to this defense critical U.S. shipbuilding industrial base.

We recognize that negotiation is the process of give and take, but in this Agreement we gave and we were taken. We respectfully urge this committee and Congress to insist that the administration renegotiate this Agreement to one that is truly equitable for American shipyards.

Thank you, sir.

[The prepared statement follows:]

TESTIMONY OF MR. TOM BOWLER
PRESIDENT, AMERICAN SHIPBUILDING ASSOCIATION
ON
OECD SHIPBUILDING AGREEMENT
WAY & MEANS COMMITTEE, SUBCOMMITTEE ON TRADE
July 18, 1995

Thank you, Mr. Chairman, members of the Subcommittee, for this opportunity to testify today on behalf of the member companies of the American Shipbuilding Association (ASA) on the Organization for Economic Cooperation and Development (OECD) Agreement on Shipbuilding. ASA represents America's six largest shipbuilding companies employing approximately 95 percent of all shipbuilding workers in the United States.

ASA member companies are: Avondale Shipyards, Bath Iron Works, General Dynamics' Electric Boat Division, Ingalls Shipbuilding, National Steel and Shipbuilding, and Newport News Shipbuilding. These shipbuilders are the largest private employers in five states: Louisiana, Maine, Rhode Island, Mississippi, and Virginia. They are also a major source of business for thousands of firms -- large and small -- that make up the marine supplier industrial base in 46 of the United States.

Every economic and military power throughout history has recognized the need to manufacture ships for their commerce and national security. The ancient Ottoman Empire, Roman Empire, Spain, and the British Empire all had one thing in common -- they controlled their seas. America rediscovered this necessity in the Allied victory of World War II. Most recently, ships were critical once again in the Persian Gulf conflict, where 95 percent of all military cargoes were transported by sea.

A 1988 report by the U.S. Commission on Merchant Marine and Defense found that for every job created in a shipyard, five more were created throughout the domestic economy. Countries such as Japan and S. Korea, and now China, have recognized the tremendous benefits of shipbuilding in developing their national economies. As a result, Japan, in the 1960's, targeted shipbuilding, and South Korea followed the Japanese example in the 1970's. Japan and S. Korea now dominate commercial shipbuilding with 70 percent of the total market.

Unfortunately, U.S. policy makers either forgot, or chose to ignore, the critical importance of shipbuilding to our economic strength and to our military might. In 1981, the U.S. Government unilaterally terminated direct subsidies to the U.S. shipbuilding industry. Foreign nations responded by dramatically increasing their own domestic shipbuilding subsidies. These foreign subsidies, in the form of direct grants, construction and modernization of shipbuilding facilities, research and development, and subsidized loans, enabled foreign shipbuilders to dramatically increase their market share. Unable to compete against such government support, American shipbuilders -- who had historically been producers of both commercial and naval vessels -- lost their commercial shipbuilding market share. Since 1981, more than 140,000 American shipbuilding jobs have been lost as U.S. shipbuilding capacity was cut in half.

While foreign shipbuilders honed their commercial shipbuilding skills, American shipbuilders focused their efforts on building the most superior naval vessels in the world. Today, ASA shipbuilders make up this Nation's critical Navy shipbuilding industrial base. This year, however, marks the lowest level of Navy shipbuilding in 47 years. The President's fiscal year 1996 budget requests funding for only three Navy ships. Over the next five years, an average of only five ships per year are expected to be ordered for the U.S. Navy. At the turn of the century, however, the Navy projects that 10 to 12 ships will have to be ordered annually if the Nation is to sustain a 346- ship fleet. Without these core shipbuilders, these military requirements cannot be met. If we are to survive this six-year period of limited Navy ship orders, we must recapture commercial market share.

At the outset of the OECD negotiations in 1989, ASA member shipbuilders insisted that for an agreement to be acceptable it would have to be specific, comprehensive, enforceable, and provide a level field on which American shipbuilders could compete. No ASA shipbuilder -- and no spokesperson for this industry -- ever said that any agreement, regardless of its content, would be acceptable or better than no agreement at all. Unfortunately, this agreement hurts, rather than helps, our chances at recapturing commercial market share.

During these negotiations a confluence of circumstances have allowed our foreign competitors to secure a permanent advantage in the world commercial shipbuilding market. The circumstances I refer to are these: First, since 1981, U.S. shipbuilders have been engaged almost exclusively in building Navy ships that helped bring a welcome end to the Cold War. But 1985 started a ten year decline in defense budgets, resulting in only three new combatant ships being ordered by the Navy this year.

Second, much of the world's commercial fleet began reaching block obsolescence starting in the late 1980's. Combined with expected demand for new tonnage, the worldwide shipbuilding market was projected at over 150 million gross tons throughout the 1990's, valued at more than $350 billion. Because of this projected surge in demand, U.S. shipbuilders saw the early 1990's as their window of opportunity to reenter the commercial shipbuilding market.

Third, because of this upturn in demand for new ships, our foreign competitors had no incentive to reach an agreement quickly. Consequently, our foreign competitors cleverly took advantage of our trade negotiators by reaching an agreement which would allow their subsidies to continue just long enough to capture this market upturn thereby excluding U.S. shipbuilders. Foreign subsidies will remain available for ships delivered up until January 1, 1999, and foreign government-funded facility investment has just recently been completed or will be finished within the next two years.

While our foreign competitors were making sure that the negotiations dragged on over a five-year period, U.S. shipbuilders experienced a dramatic downturn in their Navy shipbuilding market. The longer the negotiations continued, the more time foreign shipyards had to complete their facility modernization projects, and fill their orderbooks with the worldwide demand

for new tonnage, before any agreement disciplining subsidies could ever take effect. These tactics, combined with the phase-out terms of the agreement, ensure that foreign shipbuilders will continue to reap the rewards of the demand for new orders throughout this decade. Meanwhile, the window of opportunity for U.S. shipbuilders to reenter the commercial market slammed shut.

Our primary concerns with the agreement are:

1) The transition terms benefit foreign shipbuilders to the detriment of U.S. shipbuilders;
2) Construction opportunities for U.S. shipbuilders for our domestic coastwise trade could be undermined;
3) The U.S. Title XI Loan Guarantee Program will be rendered ineffective, and;
4) Loopholes, exemptions, and questionable enforceability beg the question of whether this agreement will be effective in eliminating foreign subsidies.

EXTENDED PHASE-OUT PERIOD OF FOREIGN SUBSIDIES

The American shipbuilding industry insisted from day one that foreign government subsidies would have to be phased-out within two years at most. That was in 1989, when the U.S. shipbuilding industry withdrew its Section 301 trade petition at the request of USTR in exchange for a commitment from the U.S. Government to enter multilateral negotiations. The agreement before us allows for almost a ten-year phase-out of foreign subsidy practices -- not two years, but 10. By January of 1999, foreign shipbuilders will have enjoyed almost twenty years of one-sided government subsidies. These practices have enabled Japan, S. Korea, and Europe to increase and maintain market share at the expense of American shipbuilders. These practices have given foreign shipbuilders a significant competitive advantage over American shipbuilders -- an advantage that this agreement will lock-in permanently. This phase-out schedule is totally unacceptable.

SPECIFIC FOREIGN PRACTICES TO BE COVERED

American shipbuilders also insisted that they would not support an agreement if foreign governments did not provide specific lists of their current programs and practices which would be affected by the agreement. The U.S. Government provided the other parties with a detailed list of every conceivable U.S. law or regulation that may be covered at the outset of the negotiations. Foreign governments, on the other hand, have yet to provide comparable details. In fact, Japan and S. Korea industry officials have maintained that this agreement will have no impact on their current practices whatsoever.

During these negotiations, foreign governments refused to curtail their subsidies. In 1990, for example, S. Korea provided almost a $1 billion bailout of its Daewoo shipyard, which had been selling ships below the cost of production. The European Union approved, in 1992, a $4 billion shipyard modernization program for former East German shipbuilders. During these negotiations, the six top shipbuilding nations provided $5 billion to $8 billion in subsidies annually to their industries.

SPECIAL TRANSITION SUBSIDIES TO FOREIGN SHIPBUILDERS

To add insult to injury, the U.S. Government agreed that these foreign governments were entitled to additional subsidy allowances above and beyond their current practices. Section A of Annex II authorizes over $2 billion for the countries of Spain, S. Korea, Portugal, Belgium, and France for investment assistance and for **social measures not otherwise exempted under Annex I** of the agreement. A $480 million special deal for France is not even referenced in the agreement, because it was approved after the negotiations were supposedly concluded. Since December, in spite of repeated inquiries, we have yet to receive any details on this special French subsidy package. ASA shipbuilders cannot accept these one-sided transition terms.

NEGATIVE IMPACT ON THE JONES ACT

USTR has stated that it had to agree to these special concessions for foreign governments in order to preserve the Jones Act and Passenger Vessel Act of the United States. The Merchant Marine Act of 1920 and the Passenger Vessel Act of 1886 require that vessels transporting cargo or passengers in the U.S. domestic trade be U.S.-owned, U.S.-built, and U.S.-crewed. Although USTR stated at the outset that the Jones Act would not be subject to negotiation, the agreement jeopardizes these domestic coastwise trade laws.

Annex II, Section A provides for the foreign subsidy exemptions mentioned above, and Section B addresses the Jones Act. No caveats or restrictive wording accompany the foreign exemptions. However, the section dealing with U.S. coastwise laws is riddled with caveats, exceptions, restrictive language. It also establishes a structural format by which foreign governments may continually challenge these laws. Section B, 2(b) of Annex II states -- and I quote -- "Recognizing that a permanent derogation for the coastwise laws could undermine the balance of rights and obligations of the Parties under the Agreement and is unacceptable to the other Parties ..."

Despite the use of the word "could", this is **a significant U.S. concession. In previous foreign trade agreements the U.S. has resisted the principle that access to the U.S. domestic market should be connected with access to international markets.** Rules for competition and trade in international markets have in the past been established without specific linkage or reciprocal access to domestic cabotage markets. The U.S. has conceded a precedent whereby it has to "pay" for access to international markets by restricting protections applicable to domestic markets. This precedent acknowledges that the ultimate repeal of these laws is a precondition to obtaining completely fair and equal access to international markets -- thus making eventual repeal more likely.

The responsive measures which foreign governments can take against the Jones Act differ in the first three years of the agreement's entry into force, and in the years following. In the first three years, the agreement places a 200,000 gross ton cap on vessels delivered for the Jones Act trade annually. If the tonnage cap is breached, the Parties Group may authorize one or more responsive measures against a U.S. shipbuilder who delivers a vessel for this trade and who is also seeking international market access. These measures

include imposition of a charge, or restriction on bids or contracts aimed at affecting a loss of sales opportunities comparable to that resulting from deliveries of coastwise vessels in excess of the threshold. The agreement further states that deliveries in excess of the threshold significantly undermine the balance of rights and obligations under the agreement.

After three years, the Parties Group may reexamine the measures provided for in the agreement and decide to modify the measures which can be taken -- regardless of the tonnage delivered to this trade. Furthermore, the agreement states that a Party may withdraw from the agreement at any time after four years "if Part B of Annex II remains in effect (the Jones Act)."

In the real world of market investment and market finance, the uncertainties created in this agreement with respect to the future of the Jones Act will have an adverse impact on potential shipbuilding orders for this trade, and further hasten its repeal. ASA finds the treatment of the Jones Act unacceptable.

IMPACT ON TITLE XI LOAN GUARANTEES

The Title XI Loan Guarantee Program provides a government guarantee on commercial loans for ships built in the United States. This program was essentially dormant throughout the 1980's. In fiscal year 1994, Congress revived and amended the program as part of the National Defense Authorization Act. Prior to FY'94, a Title XI loan guarantee was available only to U.S. citizen shipowners who registered their ships under the laws of the United States. The FY'94 amendments made the terms of the program more favorable and made the guarantees available for ship exports and shipyard facility modernization. These guarantees can cover up to 87.5 percent of a 25-year loan.

The revitalization of this program was responsible for a member ASA company obtaining an export order for four double-hulled oil tankers. This contract marked the first commercial ships to be built in the United States for export **in almost 40 years**. Because of this program, another ASA company is converting four single-hulled U.S.-flagged tankers to double hulls, and another has contracts to build four double-hulled ships for the Jones Act trade.

The agreement calls for major modifications to this program. The guarantees will be reduced from 87.5 percent of the loan to only 80 percent of the loan. Rather than the guarantee being available for 25 year loans, it will only cover 12-year loans. As a result, the only program which has actually helped U.S. shipbuilders will be rendered ineffective. ASA opposes these changes to the Title XI program.

EXEMPTIONS FOR RESEARCH AND DEVELOPMENT

Annex I specifically provides for an exception for government funded research and development in the area of commercial shipbuilding and marine components. Throughout the 1980's, and until 1994, the U.S. Government contributed no more than $1 to $2 million annually for commercial shipbuilding research -- which was matched by U.S. industry. By comparison, we know

that Japan was providing close to **$1 billion** in some years during this same period.

In fiscal year 1994, the U.S. Government recognized the need to do more in this area, and initiated the MARITECH program. Under MARITECH, shipbuilders must match the governments contribution along a 50/50 share line. For FY'96, the President has requested $50 million for this program.

The agreement allows governments to continue to fund 100 percent of "fundamental research"; 50 percent of "basic industrial research"; 35 percent of "applied research" (which is defined as research through development of a prototype); and, 25 percent of "development" (which is defined as to include development of pre-production models). The government percentage for each of the above categories may be increased by 25 percent if the research and development is for environmental or safety purposes. One would be hard pressed to find a research or development project that could not be placed in a safety or environmental category. Thus, this exception will ensure a 15 to 50 percent advantage to foreign governments above what is currently being provided to U.S. shipbuilders, since no U.S. program is funded above a 50/50 share line. Furthermore, there is no restriction on the cumulative amount of money a foreign government can spend on commercial research and development -- as long as the share lines are followed. This exception is far too broad and unacceptable to ASA.

LOOPHOLE FOR MARINE COMPONENT MANUFACTURERS

The agreement will not apply to subsidies for the manufacture of vessel components, such as bridge equipment, engines or machinery. Even though the agreement prohibits indirect subsidy to any person "where the benefit is passed, or may reasonably be expected to be passed, to the shipbuilder or ship repairer indirectly," we are concerned that the transparency provisions of the agreement can be interpreted to not apply to vessel components.

Approximately 50 percent of the value of a ship is in its components. This percentage will vary, but 50 percent is a reasonable average to use. If subsidies continue to flow to foreign vessel component manufacturers, this agreement would have little impact on subsidized ship prices. Furthermore, because of the exception to government funded research and development, foreign component manufacturers can continue to reap government benefits not provided to U.S. vessel component manufacturers.

INJURIOUS PRICING PROVISIONS

Annex III of the Agreement deals with injurious pricing - or the selling of ships below normal prices. Under the procedures of the agreement, a "domestic industry" must file a complaint with its government, the "investigating party". A "domestic industry" is defined generally as "the domestic producers as a whole of the like vessels."

The agreement provides a direct and indirect means for a builder to file an injurious pricing allegation. A shipbuilder may bring a direct injurious pricing action only against a buyer which is a company or who is a national of the shipbuilder's country. If the buyer is not a company or national of the

shipbuilder's country, an indirect procedure, known as a "third country" complaint, would have to be pursued.

A U.S. shipbuilder, upon filing a direct or indirect injurious pricing charge, would have to present evidence of both the practice and how the practice has injured the U.S. shipbuilding industry. Injury is very difficult to prove for all industries -- even those which enjoy a significant portion of the commercial market. U.S. shipbuilders, who have less than one percent of the commercial shipbuilding market, and who have built relatively few commercial ships over the past 15 years, will be hard pressed to prove that they are injured by these practices.

A U.S. shipbuilder would have limited, indirect recourse against a sale to a non-U.S. buyer. Under the "third country" procedures, the United States, as the "third country" would apply to the country of the vessel buyer to bring an injurious pricing action on behalf of the United States. Since the buyer's country has discretion to pursue an action on behalf of the third country, this provision may be of little assistance to the third country shipbuilder. If for example, the buyer's country doesn't find it to be in its best interest to bring an action, then there would be little or no recourse for a third country against unfair, or below normal, pricing practices.

Injurious pricing practices are a concern to American shipbuilders. Japan and S. Korea obtained their 40 percent and 30 percent market share, respectively, in part, by selling ships below their cost of production. Currently, S. Korean shipyards are in the midst of doubling their shipbuilding capacity -- during a time when excess capacity already exists. Injurious pricing normally accompanies excess capacity. If S. Korean shipbuilders resume their previous practices, U.S. shipbuilders have little expectation that this agreement will be effective in correcting the practice. Even if the buyer's country were to agree to bring a case on our behalf, and even if there were compelling evidence of injurious pricing, it would be very difficult to prove injury.

OTHER LOOPHOLES AND GENERAL CONCERNS

Annex I, Sections A and B, states that tax policies which are beneficial to the shipbuilding industry are a violation of the agreement. It is our understanding that the implementing legislation to this agreement will recommend repeal of the U.S.-build requirement associated with the Capital Construction Fund (CCF). The CCF, which is a tax-deferred program for shipowners for the purpose of building ships, will continue to be available for U.S. shipowners. I would like to make it clear that American shipbuilders do not support our government undertaking a policy or practice of **subsidizing foreign ship construction -- which would be the effect of this provision.** Furthermore, the fact that this tax policy can continue under the agreement, as long as it is not available solely for ships built in the United States, begs the question of just what this agreement does and does not cover. ASA supports continuation of the CCF in its current statutory form.

Section C of Annex I, entitled "Official Regulations and Practices" probably provides another reason why the Asian shipbuilders do not believe this agreement will affect them. Although this section states that anti-competitive

arrangements such as price fixing, bid-rigging, market allocation, and other predatory practices are to be disallowed, an accompanying footnote states that the parties recognize that differences exist among countries' competition policies or laws and regulations, and that the agreement is not intended to unify competition policies among the Parties "**nor to compel a Party to amend its national competition laws and regulations.**" (Emphasis added)

It is well known that the U.S. Government has some of the strictest anti-trust laws in the world. While these laws will continue to govern our practices, Japanese and other foreign shipbuilders would be allowed to continue their practices, which would be considered anti-competitive and illegal in the U.S..

Although ASA questions just how effective this agreement will be on ending foreign shipbuilding subsidy practices, we are absolutely certain that it will preclude the U.S. Government from ever assisting U.S. shipbuilders -- even if it were for national defense purposes.

This agreement will outlaw creative ideas in the future aimed at preserving the U.S. defense shipbuilding industrial base. It will tie the hands of American shipbuilders while foreign governments continue their current practices or find more clever and more discreet ways to continue to subsidize their shipbuilders. President Clinton, in a speech last month in the Pacific Northwest, said, and I quote: "The American business community and American workers want stable jobs in a global economy. They need the United States Government out there doing for them what other governments are doing for their business communities. If we don't do that, we will pay a big price ..."

I do not think the President would support this agreement if he knew the details, and truly understood what its impact will be on our defense shipbuilding industrial base. This agreement locks in the competitive advantage foreign shipbuilders have over us as a result of years of government subsidies. It provides overly generous transition terms for foreign governments until January 1, 1999, and special restructuring deals above and beyond their current subsidy practices. By contrast, American shipbuilders, who have received no direct subsidies from their government in 15 years, and who have only recently benefitted from indirect programs, such as Title XI and MARITECH, are supposed to magically overcome a 20-year disadvantage in commercial shipbuilding. The terms of this agreement are not in keeping with President Clinton's, or the Congress', vision of the role of our government with respect to industry. Although ASA recognizes that the art of negotiation is the process of give and take, our assessment of this agreement is **that we gave and we were taken.**

We urge this Committee and Congress to insist that the Administration renegotiate this agreement. We ask for an agreement that is truly equitable for American shipbuilders. Too much is at stake to accept anything less.

Thank you. That concludes my prepared remarks.

Mr. SHAW. Thank you, Mr. Bowler.
Mr. Fitzgerald.

STATEMENT OF DUANE D. FITZGERALD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BATH IRON WORKS CORP., BATH, ME., AND PRESIDENT OF THE AMERICAN SHIPBUILDING ASSOCIATION

Mr. FITZGERALD. Thank you, Mr. Chairman. I will be very brief.

I represent Bath Iron Works Corp., and we are Maine's largest employer, employing some 8,500 workers. It has been said that the shipyards of our association only dabble in commercial shipbuilding when the Navy business is slow. I would note for the committee that our company has built 450 ships in its history, and about half of those ships have been ocean-going vessels and capable of participating in international trade. So I would suggest that we are more than dabblers.

Why would we oppose an agreement that purports to eliminate shipbuilding subsidies around the world, something that we have worked with you, Congressman Gibbons, for some years to change? Why would we oppose an agreement that purports to do that?

Well, we do so for the reasons that this Agreement is flawed, and let me simply tick off why I think that is the case. The Agreement purports to eliminate all subsidies, but it only will do so eventually. More importantly, it does not address the effect of the subsidy practices that have gone on around the world for the last 15 years. There is no disclosure in the Agreement of the government practices that are now proscribed.

In other words, if you look to the Agreement and ask yourself what are the Japanese not going to do any more, you will find no disclosure of what their practices have been. And I submit to the committee that the forms of assistance that have been provided by governments are not always as obvious as this Agreement suggests.

Its second flaw is that it requires us to modify the terms of title XI. If we look at the last year, the only thing that has permitted us to even set foot into the world commercial market has been title XI, and the very thing that has permitted us to get a little bit of international business for the first time in many, many years will disappear in a mere 5 months.

Its third flaw, and there has been much talk about that this morning, is that it puts the Jones Act on the table. Now, if the Agreement is benign with respect to the Jones Act, then my question is why does the Agreement mention the Jones Act. And if you will look at pages 26 and 27 of the Agreement, you will note that the Agreement is hardly benign with respect to the Jones Act.

It does not address the impact of those subsidy practices that have gone on around the world. And I would note, Mr. Chairman, that the huge infrastructure benefits that foreign shipbuilders have received from their governments, and which they are receiving right now from their governments, the benefits of that form of assistance will be realized for many, many years to come and we will face that in competition without regard to the elimination of subsidies eventually.

The final flaw that I would like to mention, Mr. Chairman, is the fact that this Agreement does not address a very, very important

issue, and that is the excess capacity in shipbuilding in the world and the alarming and devastating effect that it has upon pricing.

I was very surprised to hear Ambassador Lang talk in terms of significant growth in demand. He is right, but you have to look at the other side of that curve and look at the supply side. There is excess capacity in the world projected to be growing to as much as 50 percent over the next decade, particularly because of the enormous expansion going on in South Korea.

Everyone knows that when you have excess capacity, it has an impact on prices, and that is clear if one looks at world prices in shipbuilding over the last year. In spite of increasing demand, we have seen declining prices. I submit, gentlemen, that this will continue to be the case and that it will be a principal barrier to our reentry to this market.

Finally, I would note for you that an agreement that purports to eliminate some practices around the country would presumably have the shipbuilders of that country acknowledge that certain practices would come to an end. The Japanese Shipbuilding Association and the South Korean Shipbuilding Association have stated for the record—and that could be produced for you—that this Agreement will have no effect upon them, because they are engaging in no practices proscribed by the Agreement. They have 65 percent of the world market. If this Agreement does not affect them, then that should be cause for great concern here in this country.

Finally, Mr. Chairman, I have to comment upon Ambassador Lang's statement that he has only heard rumors about the French assistance program which is clearly stated to be in the amount of $480 million. We have brought that to the Trade Representative's attention and we have received no information. And if we can get no information about that program in the last 12 months, it should cause us some pause when we think about the enforcement mechanism in this Agreement.

We are not opposed to an agreement. We are opposed to this Agreement. We think our negotiators should be asked to renegotiate certain provisions of it.

Thank you very much.

[The prepared statement follows:]

Testimony of Duane D. Fitzgerald
July 18th, House Ways and Means Trade Subcommittee

Chairman Crane, Congressman Gibbons, and Members of the Trade Subcommittee, thank you for the opportunity to present testimony today on an extremely important matter - the OECD Agreement on Commercial Shipbuilding. The critical question to be addressed today - and for the Congress to ultimately decide - has to be whether the Agreement reached last July and signed last December -- after five long years of on-again, off-again negotiations -- actually accomplishes the primary objectives the American shipbuilding industry and our national policy makers sought to achieve.

As Tom Bowler, President of the American Shipbuilding Association (ASA), and Al Bossier, President and CEO of Avondale Industries, and the ASA Vice Chairman, have testified, our country's six major shipbuilding companies which employ over 95% of American shipbuilding workers, are convinced that:

-the Agreement fails to achieve the objective of a fair and level playing field in international commercial shipbuilding, one that is free from government subsidy, other market-distorting practices and their significant, residual effects;

-the only shipbuilders whose competitive position in the commercial market, especially for the next several, critical years, is actually made worse by the Agreement are US shipbuilders;

-the Agreement's impact on the preservation of adequate US defense shipbuilding capabilities and skills for near-term and future military requirements appears to have been given cursory, at best, consideration by Executive Branch officials;

-the Congress must not, and we are confident will not, make the same mistake.

If this is a "good" trade agreement, I shudder to think what a "bad" trade agreement looks like.

ASA member companies appreciate the efforts of the Congress and the Clinton administration in the last several years to revitalize commercial shipbuilding in the United States.

We were greatly encouraged by the President's National Shipbuilding Initiative announced in late 1993 as Congress was preparing to enact similar initiatives in the Fiscal Year 1994 National Defense Authorization Act.

Unfortunately, our industry's interests were poorly served during the final series of negotiations that culminated in the OECD Commercial Shipbuilding Agreement that is before you today and which we fervently oppose.

To evaluate the argument that there are serious national security implications to the OECD Agreement - as we claim, or how much weight should be placed on those implications - you must first decide how important it is for this industry to succeed in its efforts to supplement declining naval shipbuilding work with commercial ship construction. In that regard, the Department of Defense submitted a report to Congress last year on the ADEQUACY OF THE US SHIPBUILDING INDUSTRY. Two primary conclusions of that report were:

-"For the longer term, the ability of the US shipbuilding industry to meet military requirements is problematic."

-"The best long-term solution to maintain a robust shipbuilding industrial base is to obtain a respectable percentage of the global commercial shipbuilding market."

We share the Department of Defense report's conclusions.

In my role as ASA Chairman, and also out of concern for how this Agreement's implementation could harm Bath Iron Works' business prospects and the jobs of our proud Maine company's hard-working men and women, I wrote to US Trade Representative Ambassador Kantor last December prior to the scheduled signing of the OECD Agreement. The purpose of that communication was to urge the Administration to step back from signing the Agreement at that time and to take additional steps to better understand our concerns with the Agreement.

Unfortunately, the Administration chose to go forward and sign the Agreement, despite the united opposition of the six major US shipbuilding companies which together employ more than 95% of currently active American shipbuilder workers.

We did not wait until the Agreement was signed to express our severe disagreement with its provisions. We would sincerely prefer to appear before you in support of an Agreement that merits our support and the support of this Congress. But that is not the case. I urge you not to support the Agreement or the long-awaited, but as of yet-unseen implementing legislation from the Executive Branch.

Thank you again for the opportunity to appear before you today.

Mr. SHAW. Thank you, Mr. Fitzgerald.
Mr. Bossier.

STATEMENT OF ALBERT L. BOSSIER, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, AVONDALE INDUSTRIES, INC., NEW ORLEANS, LA.

Mr. BOSSIER. Thank you, Mr. Chairman and members of the subcommittee.

As president and chief executive officer of Avondale Industries of New Orleans, La., I appreciate this opportunity to state my strong objection to the OECD Shipbuilding Agreement. Avondale Industries was founded in 1938. We are an employee-owned company and we are the largest private employer in the State of Louisiana. The livelihood of more than 6,000 men and women and their families depend on Avondale Shipyards.

In these times of scarce Navy shipbuilding opportunities, it is essential for Avondale to win commercial contracts to sustain our current work force and to grow in the future. For the last 18 months, we have made tremendous progress in our efforts to attract commercial business. This progress is due in large part to the revitalization and expanded title XI government loan guarantee program and the Oil Pollution Act of 1990.

OPA–1990 requires that single hulled oil tankers plying U.S. waters be replaced with double hulled ships between 1995 and the year 2015. Construction contracts for double hulled tankers for domestic coastwise trade, commonly referred to as the Jones Act, are just beginning to be placed with Avondale and other U.S. shipyards.

We at Avondale are currently completing a new state-of-the-art facility which will revolutionize our efficiency and competitiveness in the construction of commercial, as well as naval vessels. This $20 million investment will maximize throughout efficiencies in the cutting and assembly of steel in the construction process of commercial ship modules. The title XI loan guarantee program made this investment possible and affordable for my company.

It was title XI that also made it financially feasible for American Heavy Lift Shipping Co. of Louisiana to finance a $140 million conversion of four single hulled tankers to double hulled tankers, a contract which Avondale won in March of this year. This work represents as many as 1,000 jobs for our employees and will generate an additional 2,500 to 3,000 jobs throughout the economy. These four American Heavy Lift tankers will serve the U.S. coastwise trade in compliance with the environmental construction standards of OPA–1990.

Three other ship operating companies are now discussing with Avondale their interest in having double hulled tankers built for the Jones Act trade. They have stated to me, however, that they will only place these orders if the terms of the current title XI program remains in place.

These business opportunities for my shipyard and other U.S. shipbuilders will disappear under this Agreement. This Agreement will render the title XI program ineffective and it will seriously jeopardize the United States build requirements of the Jones Act. With respect to title XI, the program will be reduced from its cur-

rent terms of 87.5 percent of a 25-year loan to 80 percent of a 12-year loan. In the world of shipbuilding, as with the home mortgage business, financing rates and terms determine a project's affordability. Thus, owners who need to replace their fleets will most likely find it unaffordable under these less favorable financing terms.

I am very much concerned, as my colleagues are, about the impact this Agreement will have on the Jones Act. For example, the Agreement states, "Recognizing that a permanent degradation of the coastwise laws could undermine the balance of rights and obligations of the parties under the Agreement and is unacceptable to the other parties." Despite the use of the word "could," this is a significant U.S. concession.

In previous foreign trade agreements, the United States has resisted the principle that access for U.S domestic markets should be connected with access to international markets. Rules for competition in trade in international markets have in the past been established without specific linkage or reciprocal access to domestic cabotage markets.

The United States has conceded a precedent whereby it has to pay for access to international markets, while restricting protections applicable to domestic markets. This precedent acknowledges that the ultimate repeal of these laws is a precondition to obtaining completely fair and equal access to international markets, thus making eventual repeal of the Jones Act more likely.

In the first 3 years, the Agreement places a 200,000 gross ton cap on vessels delivered for Jones Act trade annually. The Parties Group may authorize one or more responsive measures against a U.S. shipbuilder seeking international market access, if the tonnage cap is breached.

These means include imposition of a charge or restriction on bids or contracts aimed at effecting a loss of sales opportunities comparable to that resulting from deliveries of coastwise vessels in excess of the threshold. The Agreement further states that deliveries in excess of the threshold significantly undermine the balance of rights and obligations under the Agreement. It is important to point out that U.S. shipbuilders already have contracts in hand that will exceed the 200,000 gross ton cap.

After 3 years, the Parties Group may reexamine the measures provided for in the Agreement and decide to modify the measures which can be taken, regardless of the tonnage delivered to this trade. That is the real problem.

A shortage of qualified U.S.-built coastwise tankers is anticipated by the year 1996, as single hulled vessels are phased out pursuant to OPA–1990. Changes to title XI and uncertainties regarding the future of the Jones Act will reduce the likelihood that vessel owners will be able to obtain financing or be willing to commit their own resources for building ships in the United States for the Jones Act. As the shortage of qualified vessels increases, pressure could build to waive the U.S.-build requirement for double hulled tankers. These waiver requests, coupled with foreign government attacks on the Jones Act, will certainly hasten the law's repeal.

This Agreement is a bad deal for American shipbuilders. I am responsible for the employment of more than 6,000 Americans, and

I cannot support an agreement that will put my employees and my company's future at risk.

I would be very happy to answer any questions you may have. Thank you very much.

[The prepared statement follows:]

TESTIMONY OF MR. ALBERT L. BOSSIER, JR.
PRESIDENT & CEO, AVONDALE INDUSTRIES, INC.
ON
OECD SHIPBUILDING AGREEMENT
WAYS & MEANS COMMITTEE, SUBCOMMITTEE ON TRADE
July 18, 1995

Thank you, Mr. Chairman, and members of the Subcommittee. As President and CEO of Avondale Industries of New Orleans, Louisiana, I appreciate this opportunity to state my strong objections with the OECD shipbuilding agreement. Avondale Industries was founded in 1938. We are an employee-owned company, and we are the largest private employer in the state of Louisiana. The livelihood of more than 6,000 men and women, and their families, depends on Avondale. In these times of scarce Navy shipbuilding opportunities, it is essential for Avondale to win commercial contracts to sustain our current work force, and to grow.

Over the last 18 months, we have made tremendous progress in our efforts to attract commercial business. This progress is due, in large part, to the revitalized, and expanded, Title XI Government Loan Guarantee Program, and the Oil Pollution Act of 1990 (OPA-90). OPA-90 requires that single-hulled oil tankers plying U.S. waters be replaced with double-hulled ships between 1995 and the year 2015. Construction contracts for double-hulled tankers for the domestic coastwise trade, commonly referred to as the Jones Act, are just beginning to be placed with Avondale and other U.S. shipyards.

We at Avondale are currently completing a new state-of-the-art facility, which will revolutionize our efficiency and competitiveness in the construction of commercial ships. This $20 million investment will maximize throughput efficiencies in the cutting and assembly of steel in the construction process of commercial ship modules. The Title XI loan guarantee made this investment possible, and affordable for my company.

It was Title XI that also made it financially feasible for American Heavy Lift Shipping Co. to finance a $140 million conversion of four single-hulled oil tankers to double hulls -- a contract which Avondale competitively won in March of this year. This work represents as many as one thousand jobs for our employees, and it will generate an additional 2500 to 3000 jobs throughout the economy. These four American Heavy Lift tankers will serve the U.S. coastwise trade in compliance with the environmental construction standards of OPA-90.

Three other ship operating companies are now discussing with us their interest in having double-hulled tankers built for the Jones Act trade. They have stated, however, that they will only place these orders if the terms of the current Title XI program remain in place.

These business opportunities, for my shipyard and other U.S. shipbuilders, will disappear under this agreement. This agreement will render the Title XI program ineffective, and it will seriously jeopardize the U.S.-build requirement of the Jones Act.

With respect to Title XI, the program will be reduced from its current terms of 87.5 percent of a 25-year loan to only 80 percent of a 12-year loan. In the world of shipbuilding, as with home mortgages, financing rates and

terms determine a project's affordability. Thus, owners who need to replace their fleets, will most likely find it unaffordable under these less favorable financing terms.

I am very concerned about the impact this agreement will have on the Jones Act. For example, the agreement states -- and I quote -- "Recognizing that a **permanent derogation** for the coastwise laws could undermine the balance of rights and obligations of the Parties under the Agreement and is unacceptable to the other Parties ..." Despite the use of the word "could", this is **a significant U.S. concession.**

In previous foreign trade agreements the U.S. has resisted the principle that access to the U.S. domestic market should be connected with access to international markets. Rules for competition and trade in international markets have in the past been established without specific linkage or reciprocal access to domestic cabotage markets. The U.S. has conceded a precedent whereby it has to "pay" for access to international markets by restricting protections applicable to domestic markets. This precedent acknowledges that the ultimate repeal of these laws is a precondition to obtaining completely fair and equal access to international markets -- thus making eventual repeal more likely.

In the first three years, the agreement places a 200,000 gross ton cap on vessels delivered for the Jones Act trade annually. The Parties Group may authorize one or more responsive measures against a U.S. shipbuilder seeking international market access if the tonnage cap is breached. These measures include imposition of a charge, or restriction on bids or contracts aimed at affecting a loss of sales opportunities comparable to that resulting from deliveries of coastwise vessels in excess of the threshold. The agreement further states that deliveries in excess of the threshold significantly undermine the balance of rights and obligations under the agreement. **It is important to point out that U.S. shipbuilders already have contracts in hand that will exceed the 200,000 gross ton cap.**

After three years, the Parties Group may reexamine the measures provided for in the agreement and decide to modify the measures which can be taken -- regardless of the tonnage delivered to this trade.

A shortage of qualified U.S.-built coastwise tankers is anticipated by the year 1996, as single-hulled vessels are phased-out pursuant to OPA-90. Changes to Title XI and uncertainties regarding the future of the Jones Act will reduce the likelihood that vessel owners will be able to obtain financing or be willing to commit their own resources for building ships in the United States for the Jones Act. As the shortage of qualified vessels increases, pressure could build to waive the U.S.-build requirement for double-hulled tankers. These waiver requests, coupled with foreign government attacks on the Jones Act, will only hasten the laws repeal.

This agreement is a bad deal for American shipbuilders. I am responsible for the employment of more than 6,000 Americans. I cannot support an agreement that will put my employees and my company's future at severe risk.

Thank you.

Mr. SHAW. Thank you, Mr. Bossier.
Mr. St. Pé.

STATEMENT OF GERALD J. ST. PÉ, PRESIDENT, INGALLS SHIPBUILDING, INC., PASCAGOULA, MISS.

Mr. ST. PÉ. Thank you very much, Mr. Chairman. I am last here this afternoon, and I will also be brief. I thank you and other members of the panel for the patience and, more importantly, for the time and attention that you have given to this important subject.

I am president of Ingalls Shipbuilding of Pascagoula, Miss. We have 14,000 employees in our company. Like others of my associates here, I am the largest employer in the State of Mississippi.

My comments to you here this afternoon are centered around an appeal, and that is to ask you and other members of this committee and the Congress overall, as you proceed to deliberate and to decide the fate of this piece of legislation, that you remain, as indeed we all should remain, focused on the real issue here.

Revitalization of commercial shipbuilding in this country is not about building commercial ships. It is not about creating new and expanded markets for those of us who are in this business. It is not about free trade. It is not about fair trade. It is not about protecting subsidies. It is not about trying to find ways to get new and expanded subsidies.

The objective over the past 10 years, the objective that was associated with the initial negotiation of this Agreement is not about all those things. It is about protecting and preserving the shipbuilding industrial base of this country because, and only because of its importance to national defense.

Mr. Bowler in his opening testimony on behalf of the association said to you that we represent 95 percent of the shipbuilding employees in this country today. We also represent 95 percent of the capacity. And I will be so bold as to say to you this afternoon that when one considers the complexity and difficulty and response time associated with building sophisticated complex naval vessels, we represent 100 percent of the know-how and experience in building those kinds of ships that are required today and will be required in the future for the U.S. Navy.

So we come to you today with not just a view from the boiler room, but with views from the bridge, and we say to you that if in fact the objective, if not the only objective, the major objective of the revitalization of commercial shipbuilding in this country is to preserve the shipbuilding industrial base of this nation. We are saying to you that this Agreement not only does not contribute to that objective, but very well will bring about an enhanced demise of the shipbuilding industrial base in this country and its related importance to defense. That certainly is not good for our industry, it is not good for America, and it is not good for the defense of America.

Thank you very much, Mr. Chairman.
Mr. SHAW. Thank you, Mr. St. Pé.
Mr. Gibbons.
Mr. GIBBONS. Mr. St. Pé, that was a good talk. It would have gone over real good around here in about 1970, but this is 1995 and there is not anybody listening any more. You are going to have

to make it on your own and you have to make it with the defense contracts you can get out.

The Defense Department has said they are not going to subsidize shipbuilding any more. There is nobody at this table that is going to subsidize shipbuilding any more. There is nobody out there in the House of Representatives that is going to subsidize shipbuilding any more. It is just gone. I hate to tell you that, but it is gone. You have seen your last subsidy.

For the life of me, we went into this negotiation with no trump card, with no aces in the hole, and we got a good agreement that everybody else in the industry except your six yards support, everybody else in the whole industry except you who build all U.S. Navy ships. I am sorry, it is over.

Mr. ST. PÉ. Mr. Chairman, if I have left you with the impression that our interest is the protection of the expansion of subsidies, then I have failed. I am not a proponent of subsidies. I would not be here today supporting the issue of expanded or protectionist subsidies.

I am saying to this committee that if in fact the objective of this Agreement at the outset was to contribute to the preservation of the ability of this country to build and maintain warships, this Agreement does not contribute to that objective.

Mr. GIBBONS. No, it was never designed to do that. This Agreement is designed to help make America competitive in the commercial shipbuilding operations of the world and to preserve whatever advantage we have under the Jones Act. The Jones Act people were in here and you heard them just a while ago saying they think this is a good agreement. This gives them what they think is necessary for the Jones Act to survive.

I do not know of anybody that knows that industry any better than the people that participate in it all the time. Now, you all participated in it when you have not got enough Navy contracts, but that is the only time you will get involved in the Jones Act.

Mr. ST. PÉ. Mr. Chairman, there is a belief here I believe that somehow or another those of us who build naval vessels jump in and out of the commercial marketplace. As you know better than anyone, there has been no commercial marketplace in this country for 15 years.

Mr. GIBBONS. Longer than that, really.

Mr. ST. PÉ. And so to attempt to characterize—not you, but others—that somehow or another we sit on the sidelines and jump in and out when it meets our own personal interest is clearly inaccurate. I am not building commercial ships because there are not any commercial ships to build. That is the reason I am not building commercial ships.

Mr. GIBBONS. Well, you are not going to build commercial ships because there is no way you can compete against the international subsidies out there. You are a businessman and smart enough to know that unless you have got the government matching every subsidy that every competitor has got, there is no way you could get any commercial ships contracts.

One of you represented that the Norfolk Yard recently got a commercial shipbuilding contract. You know, as soon as we signify that we are not going to ratify this Agreement, every other nation is

going to beat us in the subsidy game on what we call title XI subsidies. As one of you said before on the earlier panel, nobody got any benefits out of it for about 20 years.

You know, we have got a standstill agreement on this that they cannot match our title XI subsidies, but as soon as the standstill agreement runs out, and it will run out the moment they understand that we are not going to ratify this Agreement, they are all going to be in the title XI business bigger and better than we are. The one or two contracts that we have gotten at Norfolk for a couple of ships in international trade is going to vanish for the rest of us. It is just not there.

We are not in the subsidy business any more in the United States. We went out of it in 1981 under the Reagan administration, and we are out of it under the current administration. I cannot see us ever getting back into the subsidy business again.

Mr. ST. PÉ. And I applaud you for that philosophy.

Mr. GIBBONS. Those are all the questions I have, Mr. Chairman.

Mr. SHAW. Mr. Rangel.

Mr. RANGEL. I am going to need some help from you. I know we have to go vote and you can leave, but please leave at my office some answers to some of these questions. Because if I am your best friend, you have got a problem.

First of all, Mr. St. Pé, if you are doing this for the national defense, there is no one in the House more patriotic than me, but I am not the head of the Pentagon. So unless I can get some signals from those that have the responsibility of protecting us, I am not inclined to go there.

Second, I have been fighting a lot of losing fights, and this looks like this could be the best one you have given to me, because if every nation that is involved has already signed on and the Republican majority has already signed on and the President of the United States has signed on and the representatives from the shipbuilding communities have signed on, and the people in my district have not said anything yet, then I am going to take a walk to the floor and try to figure this thing out. But it does not look like I have much to work with except being friendly to whatever shipbuilders we have left.

Mr. Bossier.

Mr. BOSSIER. I think the real issue here is not the issue that we are asking for subsidies. What we are asking for is time to catch up. If you look at what has happened since 1981, it is true, we have all built generally ships for the Navy. In that period of time, our competitors———

Mr. RANGEL. Let me be rude and interrupt because of the time factor. It is a question of not what you want which is be fair and equitable, but if this train has left town already, I do not see how I could possibly convince the President and this Congress to renegotiate. I am assuming that you are 100 percent right, because I like what you are saying, and I am assuming it is a bad deal.

I am just saying I do not see how you reopen this thing with all of the countries that are involved, with all of the governments that are involved, and with this government where my issues have been beaten the most on, this looks like one of the most difficult tasks I would have.

So you can tell me how you would like this deal to be renegotiated and you can leave word in my office and I will be back in 5 minutes.

Mr. SHAW. I have a couple of questions, but there are two votes on the floor. I do not want to keep this panel any longer. I will submit them in writing and request that you answer them and we will make them a part of the record. One of them has to do with the testimony of the U.S. Trade Representative's interpretation of the pricing mechanism.

[The questions and answers referred to follow:]

ADDITIONAL QUESTIONS

1. How do you respond to Ambassador Lang's interpretation at the hearing that the Agreement's injurious pricing mechanism is effective because it permits a U.S. petitioner to bring a case against any shipbuilder, including non-U.S. shipbuilders, as long as they sell a dumped ship in the United States?

2. You stated in your testimony that you believe the United States should renegotiate the Shipbuilding Agreement. Please provide us with information as to which issues you would renegotiate and what the United States should give up in order to receive new concessions from our trading partners?

3. As to Title XI:

   - I am interested in your views as to whether the Agreement actually preserves, for a time, an advantage for the United States in its loan guaranty export credit program and that after that time, Title XI may continue, although at the levels required by the Agreement. In other words, does our industry have an advantage because the United States has a more favorable program, and no country may increase its programs to the U.S. level because of the standstill agreement?

   - Is it true that if we were not to implement the Agreement, our partners would be permitted to quickly increase their benefits to the U.S. level or higher, thus destroying any U.S. advantage in Title XI that may exist now?

AMERICAN SHIPBUILDING ASSOCIATION
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Telephone: (703) 418-4800 • Fax: (703) 418-4804

July 24, 1995

The Honorable E. Clay Shaw, Jr.
Subcommittee on Trade
Committee on Ways and Means
House of Representatives
Washington, DC 20515

Dear Mr. Shaw:

Thank you for the opportunity to respond to additional questions following the hearing before the Subcommittee on Trade on the OECD Shipbuilding Agreement.

Enclosed are the responses of the American Shipbuilding Association to those questions. Please contact me is you have further questions or desire additional information.

Sincerely,

R T E Bowler III

R. T. E. Bowler, III
President

Enclosure

Answer to Question 1:

As explained in my testimony submitted for the record, ASA member companies believe it would be very difficult to prove injury under the Agreement's injurious pricing procedures.

(1) A US petitioner is permitted to bring a case only against a buyer (not the shipbuilder) which is a company or who is a national of the shipbuilder's country. If the buyer is not from the shipbuilder's country, then a "third country" complaint would have to be pursued. This would require the US government, on behalf of a US petitioner, to file an injurious pricing case with the government of the country of the vessel buyer. It is then at that country's government's discretion to pursue the action against the shipbuilder.

(2) Proving injury is very difficult, even for those who currently have a significant commercial market share of a product. US shipbuilders, with less than 1% of the commercial shipbuilding market, and who have received orders for only a small number of commercial ships over the past 15 years, would find it extremely difficult to prove injury, even if compelling evidence of injurious pricing existed.

ASA requests that the Committee ask USTR to provide historical statistics on the success of US industries, who have a very small international market share, in proving injury.

In contrast to the injurious pricing provisions in this agreement, legislation sponsored by Rep. Gibbons in previous Congresses, and strongly supported by all US shipbuilders, had a very strong enforcement mechanism which would have allowed swift, direct sanctions against any buyer of a subsidized ship.

Answer to question 2:

(1) Title XI loan guarantee terms should be allowed to continue as they currently exist, that is, with loan periods of up to 25 years and guarantees of up to 87.5% of the loan. (The justification for this is amplified in the answer to question 3.)

(2) All references to the Jones Act should be stricken from the Agreement. The USTR has stated repeatedly that this Agreement does not change the "home build" requirements in the Jones Act and other US coastwise trade laws. USTR characterizes this as a "permanent exemption to the Agreement rules." However, this Agreement unarguably establishes a mechanism, for the first time, for another country or foreign party to challenge the Jones Act. The Agreement acknowledges ". . . that a permanent derogation for the coastwise laws could undermine the balance of rights and obligations of the Parties under the Agreement and is unacceptable to the other Parties. . . ."

USTR officials have taken the position that a successful challenge to the Jones Act is unlikely, given the steps required by the Agreement. Their rationale is based on the view that, if a country mounts a challenge based on the 200,000 gross ton annual cap for Jones Act deliveries by US shipyards having been exceeded, any penalty would have to be agreed to by all parties and this is such a small amount in comparison to the total world market that demonstrating market distortion would be unlikely. This analysis is interesting, given that USTR does not take seriously our concern that proving injury by US shipyards, as noted above, would be difficult for the same reason.

The agreement's challenge to the Jones Act is clearly aimed at shipyards who produce large, oceangoing vessels for both the Jones Act market and the international market. Shipyards who produce non-oceangoing vessels, e.g., barges and gaming boats or vessels only for the Jones Act trade will likely not be affected by this agreement. Their views on this agreement should be weighed accordingly.

Our firm belief is that the only way to truly protect the home build requirements of the Jones Act "permanently" is to remove the caveats associated with the Jones Act exemption and to acknowledge in the Agreement specifically that it is not intended to apply to the Jones Act in any way.

(3) All direct subsidy payments should cease no later than two years after reaching the agreement, i.e., July 1996. Contrary to representations made by other witnesses and alluded to by several Subcommittee Members, the ASA is not opposing this agreement because it is seeking reinstatement of subsidies. The Shipbuilders Council of America (SCA), the trade association to which ASA member shipyards then belonged, made a strong effort last year to gain approval of a temporary series transition payment (STP) program. That was done for several reasons:

- We sought approval of a transition program before an agreement even appeared achievable. After the agreement was reached last July, it became clear that it would allow other countries to continue their existing subsidy programs until January 1, 1996, and continue subsidy payments on ships that could be delivered until January 1, 1999, and that additional support programs had been grandfathered.

- The program we sought was a very modest and temporary one that was in concert with the phase-out schedule in the agreement for foreign subsidy programs. However, the Administration strongly opposed our efforts, even though the agreement was not yet signed, saying that it violated the spirit of the agreement. Yet, the French government got approval from the EU to carry out an unspecified program up to $480 million after the agreement was reached and, since the details have not been provided, no one knows whether it complies with the Agreement or not. In contrast, the STP program, which passed the full House of Representatives as part of maritime reform legislation twice--once before and again after th OECD agreement was reached--clearly spelled out the nature and the phase-out period. French shipyard officials have told US shipyard officials directly that the purpose of their program is to transition from defense to commercial work.

As to concessions in return for these changes, our view is that the US conceded in 1981 what the rest of the world will concede only after January 1, 1996. There is nothing left for the US to concede.

Answer to question 3:

The Title XI program in its current form is more advantageous than the current EU credit terms. However, the enhanced Title XI program has been in effect for only 15 months, while other countries have for years offered extremely attractive financing packages, including in some cases up to five years of zero interest and then interest of only 2-3% for the remainder of the loan. Any current advantage only partially makes up for the 13 years that the Title XI program was dormant. Furthermore, that "advantage" only exists for another 5-½ months.

If the Agreement is not implemented, other governments would be free to offer whatever benefits they desired, including matching the current Title XI terms. But that is not an acceptable argument for making Title XI terms less favorable. The Title XI program is critical to ship owners and operators.

Title XI enables ship buyers to obtain financing from commercial banks. Without the current guarantee terms, financing will either not be available or it will be available only at such high rates that it would not be affordable for the ship buyer. Before Title XI was revised, ship buyers who needed and wanted to place ship orders found it extremely difficult to obtain financing, because few banks were willing to finance ships at all. Those that were would do so only at very high interest rates. The restructured Title XI program has removed much of this reluctance on the part of banks and has brought down the rates for ship loans. Thus, the issue is not that Title XI is working because it offers terms and conditions more advantageous than similar programs currently being offered by foreign governments, it is working because financing which otherwise would not be available is now available to ship buyers.

With the OPA '90 requirements for phase-out of single-hulled tankers by 2015, many owners will need to purchase new double-hulled tankers. The price for this important environmental protection measure, however, is higher capital cost for operators. The economics of replacement tonnage are questionable without continuing availability of the current favorable Title XI terms. Also, building for this market represents the most immediate opportunities for series construction in US shipyards, which is vital to helping them establish a competitive position in the international market.

Mr. SHAW. We have several statements for the record which, without objection, will be made a part of the record at this point.

This point concludes our testimony on the Shipbuilding Agreement. Many thanks to all of our witnesses for sharing their views and expertise with us.

At this time, this hearing is adjourned.

[Whereupon, at 12:41 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT ON THE OECD SHIPBUILDING AGREEMENT
SUBCOMMITTEE ON TRADE
HOUSE COMMITTEE ON WAYS AND MEANS
JULY 18, 1995

COUNCIL OF EUROPEAN AND JAPANESE NATIONAL SHIPOWNERS' ASSOCIATIONS (CENSA)

INTRODUCTION

The Council of European and Japanese National Shipowners' Associations (CENSA) is pleased to submit comments in connection with the hearing before the Committee. CENSA is comprised of the National Shipowners' Associations of Belgium, Denmark, Finland, France, Germany, Greece, Italy, Japan, the Netherlands, Norway, Sweden, and the United Kingdom plus individual liner operators/container consortia from most of those countries. In substantial measure, these countries and their shipowners represent a large majority of the trading partners of the United States.

OECD SHIPBUILDING AGREEMENT

Shipowners are the customers of the yards which will be governed by the Agreement and we are therefore in a unique position from which to comment on its substantive impact not only on ourselves as carriers but also on our customers - the world's importers and exporters. Ultimately it will impact on the consumer and we believe the impact will be favorable.

Before spelling out the reasons for our view we would wish briefly to recall the Agreement itself, in particular what is its goal? To use an overworked but nonetheless appropriate cliché its aim is to bring about a level playing field for competing shipyards in the OECD countries and Korea. Bearing in mind that these countries provide 85% of the world shipyard capacity then, if the Agreement is ratified by all those countries (and there are positive indications that Poland will also join in due course), it will undoubtedly prove to be effective.

How will the Agreement achieve its purpose? It will do so through three basic provisions:

i. a subsidies discipline which will outlaw direct and indirect subsidies;
ii. an injurious pricing discipline which will make anti-dumping applicable to shipbuilding for the first time;
iii. a binding dispute settlement procedure backed up by sanctions in case either the subsidies or injurious pricing disciplines are violated.

CENSA'S POSITION ON THE AGREEMENT

CENSA has followed the long series of negotiations in Paris with close attention and has made its views known to the OECD at the appropriate time both through the Business and Advisory Committee (BIAC) to the OECD, and also directly with Ambassador Stoffan Sohlman who chaired the OECD Council Working Group in its latter stages and steered it to a successful conclusion. In this connection CENSA wrote to Ambassador Sohlman on November 3, 1993 as follows:

"In our view success will lead to the establishment of an unfettered market with resulting benefits for the carriers and the seaborne transport of goods: on the other

hand failure could result in unilateral actions, which would artificially impede world trade.

We are therefore unequivocally in favor of a balanced and effective OECD multilateral agreement which will:

- phase-out all market distortions in the form of subsidies to shipyards,

- phase-in a complaint driven injurious pricing code."

The position CENSA took during the negotiations and in its letter to Ambassador Sohlman was entirely consistent with the statement made before the Trade Subcommittee of the Committee on Ways and Means when it held a hearing on HR 1402 (the Gibbons Bill) in July 1993. The CENSA comments in that statement outlined the rationale for CENSA's position as follows:

"CENSA's principal objective has always been and continues to be the promotion of free access to shipping markets with the minimum of governmental regulation and intervention. With respect to the shipbuilding market, CENSA has supported policy objectives throughout the world which seek removal of the artificial distortions caused by government intervention in the form of direct grants, noncommercial levels of credit and artificial interest rates. In CENSA's view, so long as these government subsidies exist, which by their nature encourage excess shipyard capacity and over-ordering, over-tonnaging will continue to exist. The problem of phasing out market distortions caused by shipyard subsidies raises difficult issues among nations, and such issues cannot be successfully addressed unilaterally. Only a multilateral approach will permit a resolution which does not disrupt international trade and commerce."

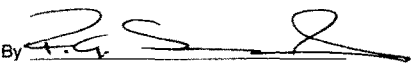
CONCLUSION

The foregoing record exemplifies CENSA's commitment to the development of international free markets in which artificial distortions caused by governmental intervention are eliminated. We therefore believe that ratification of the OECD Agreement by all parties is essential to remove distortions in the shipbuilding market. Ratification will be to the good of U.S. foreign commerce and ultimately the U.S. consumer.

CENSA appreciates the opportunity to present its views on this important issue.

Respectfuly submitted,

COUNCIL OF EUROPEAN & JAPANESE
NATIONAL SHIPOWNERS' ASSOCIATIONS

By 

Peter G. Sandlund
Washington Representative

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STATEMENT OF PHILIP J. LOREE, CHAIRMAN
FEDERATION OF AMERICAN CONTROLLED SHIPPING (FACS)
BEFORE THE SUBCOMMITTEE ON TRADE
OF THE
HOUSE COMMITTEE ON WAYS AND MEANS
ON
IMPLEMENTATION OF OECD SHIPBUILDING AGREEMENT
JULY 18, 1995

I appreciate the opportunity to submit this statement on behalf of the Federation of American Controlled Shipping (FACS) for the record of your Committee's hearing.

The membership of FACS comprises American based companies with an economic stake in owning, operating, managing, chartering, financing, or otherwise utilizing open registry vessels, and which share a common interest in preserving competitive open markets in international shipping.

FACS staunchly opposed various bills in earlier years introduced by Congressman Sam Gibbons and Senator John Breaux on the ground that those proposals would have interfered with the free movement of vessels in international commerce and would have unjustly penalized shipowners and cargo owners. We viewed the dispute over shipyard subsidies offered by various nations as a matter in which shipowners and cargo interests were truly innocent third parties and urged that the dispute be resolved on a multilateral basis under the auspices of OECD rather than on a unilateral basis in the United States and possibly elsewhere.

In December 1994, due in part to the pressures exerted by the Gibbons and Breaux bills, the major shipbuilding nations, spurred on by the U.S. government as the primary moving party, accomplished the formidable task of finalizing the OECD Agreement Respecting Normal Competitiveness Conditions in the Commercial Shipbuilding and Repair Industry (the "OECD Agreement"). In order for the OECD Agreement to enter into force on January 1, 1996, it must be formally approved by the signatories. This will require the enactment of various legislative amendments to conform U.S. law to the undertakings in the OECD Agreement.

The OECD Agreement is not without its flaws, but we believe that it nonetheless appears to stand a reasonably good chance of achieving a substantial reduction in the level of shipyard subsidies in the years ahead. The OECD Agreement would also operate to reduce the artificial stimuli to overtonnaging that result when governments, seeking to maintain employment levels in their domestic yards, offer generous subsidies to induce orders for new construction. Under the terms of the OECD Agreement subsidy disputes would be resolved in the future through agreed upon procedures that would avoid the threat of unilateral disruption of vessel movements.

For these and other reasons FACS supports implementation by the United States of the OECD Agreement, subject, of course, to a review of the provisions in the implementing legislation itself, which at this writing has not yet been made available.

In urging your Subcommittee to act expeditiously in implementing the OECD Agreement so that the year-end deadline will be met, we believe that the following considerations are worthy of mention:

... As the major proponent of the OECD Agreement, the United States should not be placed in the indefensible position of being the nation which refused to implement it.

... Implementation by the United States will assure that other signatories formally accede to the OECD Agreement, despite the objections of shipyards in some nations which do not want to give up their subsidies.

... The failure of the United States to implement the OECD Agreement would, on the other hand, provide an excuse for some signatories to continue to accommodate the demands of their domestic yards for continued subsidies.

... It is implausible to argue that the failure of the United States to implement the OECD Agreement would cause other signatories to agree to renegotiate the OECD Agreement on terms more favorable to U.S. interests, given the pressures on some to continue their subsidy programs and their belief that the OECD Agreement already favors U.S. interests over their own interests.

... Given the high probability that the United States will not enact new subsidies in support of commercial shipbuilding in the years ahead, the OECD Agreement offers U.S. yards the best hope of assuring that foreign yards will not continue to receive subsidies and/or obtain further subsidies which would distort competition and thereby disadvantage U.S. yards.

... The six U.S. yards which oppose implementation include the yards which strongly advocated negotiation of the OECD Agreement more than five years ago and which continued to advocate a subsidy free world for commercial shipbuilding virtually up and until the OECD Agreement was finalized.

... The six U.S. yards which oppose implementation of the OECD Agreement are primarily engaged in defense related work which is not even covered by the OECD Agreement.

... The U.S. yards favoring implementation of the OECD Agreement can compete internationally for commercial work in a subsidy-free environment and thus the OECD Agreement will enable them to be viable international competitors for commercial ship construction and repair work in the years ahead.

* * * *

In conclusion, we urge your Subcommittee to give favorable consideration to implementation of the OECD Agreement.

STATEMENT OF THE
MARITIME TRADES DEPARTMENT, AFL-CIO
AND THE
AMERICAN FEDERATION OF LABOR - CONGRESS OF INDUSTRIAL ORGANIZATIONS
ON THE
1994 ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT
SHIPBUILDING AGREEMENT

SUBMITTED TO THE
COMMITTEE ON WAYS AND MEANS TRADE SUBCOMMITTEE

JULY 18, 1995

American maritime labor unions have followed with considerable interest and anticipation the United States Trade Representative's efforts to secure fair competition in international commercial shipbuilding markets. Following abandonment of Construction Differential Subsidy (CDS) funding as part of the 1981 Budget Reconciliation Act, domestic shipyard employment has shrunk by 80,000 skilled technicians and laborers. Additional hundreds of thousands of jobs in related industrial pursuits also have been terminated. In many instances, their occupational talents have been lost forever when most workers were forced to settle for employment demanding alternate skills.

The American Federation of Labor-Congress of Industrial Organizations (AFL-CIO) and the Maritime Trades Department, AFL-CIO (MTD), along with its 40 affiliated unions, have promoted federal government intervention to bring fair play to international shipbuilding practices. Recognizing the failure of unilateral U.S. action to spur similar action by other Organizations for Economic Cooperation and Development (OECD) member states and independent shipbuilding nations, resumption in CDS funding and expansion of the Title XI Mortgage Loan Guarantee was urged throughout the 1980s. This was done in response to the increased public funding of overseas shipyards by foreign governments that saw an opportunity to capitalize on U.S. abandonment of the American shipbuilding industry.

These foreign subsidies were considerable. Direct and indirect support ranged between $4 to $7 billion annually for the major OECD shipbuilding nations (Japan, South Korea, Italy, Germany, France, and Spain). The end result of these huge subsidy outlays was predictable: American shipyards were driven out of commercial construction and had to rely, almost exclusively, on naval building and repair work to survive. Yet even during a period of broad expansion, the Navy's ship needs were inadequate to maintain the shipyard mobilization base in place at the time. In the process, seven large shipbuilding yards and hundreds of related suppliers were forced to cease operations.

For the last ten years, maritime unions have worked with management to improve production costs through workplace compromises on wages, benefits and terms and conditions of employment. As a result American labor costs are now lower than the compensation paid to workers in many foreign shipyards. Despite significant productivity improvements, foreign subsidies proved too large a hurdle to overcome without renewed federal government involvement. The MTD and AFL-CIO also has lent support to the industry's efforts to eliminate foreign shipbuilding subsidies.

Dissuaded by the federal government from pursuing a solution through a 1974 Trade Act, Section 301 filing -- the industry's preferred venue for securing relief -- the MTD supported the USTR's efforts to utilize the OECD to address existing competitive disadvantages. Any enthusiasm for meaningful settlement of differences quickly evaporated, however. Starting in 1989, OECD negotiators commenced discussions on international subsidy practices. Five years passed before an agreement could be fashioned by reluctant trading partners, and only after the threat of congressional action to initiate prohibitive duties on merchant vessels built with subsidies. For foreign shipyards, this extended period of negotiations meant a continuation of massive government support and an opportunity to gain further penetration of the international shipbuilding marketplace.

Starting in 1994, American shipyards were finally accorded a measure of government funding for research activities through Maritech and reactivation of and changes in the Title XI loan guarantee program that assisted in the acquisition of private sector financing for ship projects and shipyard modernization. These annual industry supports are meager by international standards, still they helped stimulate the first orders for commercial vessels built for export in over 30 years. The pending OECD agreement calls for significant reduction in the amount and terms of Title XI loan guarantees from 87.5 percent to 80 percent of the loan, and from 25 years to 12 years duration, respectively. Both Title XI changes will have a dampening effect on new ship orders from American shipyards.

Although any government may still fund shipyard research and development activities, American shipyards remain at a distinct disadvantage. Government assistance is permitted, provided it follows public-private share guidelines. The share formulae allowed by the OECD pact ranged from 100 percent for "fundamental research" to 25 percent for "development", with intermediary levels for "basic industrial research" and applied research". An additional 25 percent public funding is permitted when the research is deemed to have environmental or safety related benefits. U.S. government funding, however, has been limited by Congress to a 50-50 ratio in recent years, regardless of the program's scope. It is likely, therefore, that foreign shipyards will enjoy a research and development funding percentage advantage that runs from 15 to 50 percent higher.

More importantly, as long as the funding share ratio falls within OECD limits, no cap is placed on the total government funding for any maritime project. A post-1981 comparison between the United States and Japan is rather telling. American yards received federal research funding of only several million dollars yearly up through 1994, while the Japanese government lavished annual funding of close to $1 billion upon its commercial shipbuilding base. As a result, the Japanese have the largest share of the world's new ship order book, while the United States is only now reentering the commercial shipbuilding market. Due to budgetary constraints that continue to influence federal planning, it is unlikely that American shipyards - regardless of a research project's value - will be able to match the governmental support that their foreign counterparts will receive.

A review of foreign government shipyard support during the ten year period between the onset of OECD negotiations and the effective termination date of shipbuilding subsidies shows clearly that American shipyards have been placed in a nearly impossible competitive position. Months after negotiations started, Daewoo Shipyard was granted a $1 billion subsidy by South Korea. In 1992, East German shipyards benefitted from a $4 billion relief package from the European Union. Throughout the negotiations, the six major shipbuilding nations made available between $5 and $8 billion annually. Nor will the phase-in period of the OECD pact bring any relaxation in government support for shipbuilding. France, Portugal, Belgium, Spain and South Korea may allocate over $2 billion under the subsidy pact for investment and social relief. U.S. trade negotiators - while well intentioned - regrettably failed to factor in the overwhelming advantage gained by foreign shipyards from hundreds of billions of dollars in unmatched government support over the last decade and a half.

In addition to the financial advantages available to them under the OECD pact, foreign shipbuilding interests also were able to secure an opening in the domestic prohibition against foreign building for Jones Act vessels. Traditionally, the United States government held that the Jones Act was not to be linked to the outcome of any international trade negotiations. This appears to no longer be the case. Under the pact, foreign governments were provided opportunities to challenge the sanctity of the nation's cabotage laws.

American shipyards and their workforces have every reason to be concerned about the shortcomings of the OECD agreement. Under present industry conditions it is inconceivable to expect that American shipyards will be able to secure an adequate share of the sizeable ship construction market that is expected to develop over the next ten years. Since the abandonment of federal shipbuilding support in 1981, American shipbuilding unions have cooperated with management to improve their competitive position. Significant productivity gains have been

achieved through a variety of measures, including radically different work rules. But labor-related cost savings can only generate a limited reduction that must be amplified through other mechanisms, including government incentives. Foreign shipbuilding nations have understood this point clearly over the last two decades as American shipbuilders were left to fend for themselves. The present OECD agreement strips away the modest U.S. government supports and protections presently in place and basically condemns American shipyards to a marginal status for the foreseeable future. With vague guarantees of compliance and questionable enforcement procedures for violations of the subsidy agreement, the MTD and AFL-CIO do not believe that the present OECD shipbuilding agreement is in the nation's best interests. We call for U.S. trade negotiators to seek a new agreement that takes into consideration the longstanding unfair advantages many foreign shipyards have enjoyed through massive government subsidies. The stakes for the nation's industrial base and national security are too great to ignore the inadequacies of the present OECD subsidy agreement.

TESTIMONY OF TOM DECKER
REPRESENTING THE PORT OF PORTLAND

BEFORE THE SUBCOMMITTEE ON TRADE
WAYS & MEANS COMMITTEE, U.S. HOUSE OF REPRESENTATIVES

INTERNATIONAL SHIPBUILDING TREATY

TESTIMONY OF THE PORT OF PORTLAND

AUGUST 1, 1995

Mr. Chairman, the Port of Portland, as the steward of the Portland Ship Yard, has a direct and immediate interest in the Shipbuilding Agreement negotiated under the auspices of the Organization of Economic Cooperation and Development (OECD). We believe that at least one provision of that Agreement, if implemented, would have a significant detrimental impact on our shipyard, Metropolitan area Portland taxpayers, and more than one thousand workers employed at and around our shipyard. Our concern relates to the elimination of the long-standing U.S. statutory requirement for payment of a 50 percent ad valorem duty on foreign repair work on U.S. flag vessels.

Portland Ship Yard Background

The Port of Portland owns and maintains one of the largest and most modern ship repair facilities in the U.S. Portland Ship Yard (PSY) is unusual in that it is owned by a public port authority, yet operated by a private repair contractor. Dry Dock 4 at PSY is the largest floating dry dock in the Americas.

Voters in Metropolitan Portland, Oregon undertook a major investment at PSY in 1976, pledging the credit of their real property to approve an $84 million ship yard expansion program. At the heart of the project was the acquisition of Dry Dock 4 to handle Very Large Crude Carriers (VLCC's) carrying Alaska North Slope oil.

While the bulk of work at the yard remains oil tankers, other repair jobs include cruise vessels, various government ships and tugs and barges. The focus at PSY is repair work, not new construction. While PSY competes with West Coast yards on some repair bids, most of the competition for PSY comes from overseas yards around the Pacific Rim.

Ad Valorem Duty Provisions of the OECD Agreement

Portland Ship Yard leaves the discussion of the overall OECD Shipbuilding Agreement to others participating in the July 18, 1995 hearing. We, as a leading ship repair, overhaul, and maintenance facility, will focus our comments on the requirement under the Agreement that will require, in implementing legislation, the elimination of the 50 percent ad valorem tariff on ship repairs. We recognize that the elimination of this tariff will only apply to ships repaired in yards of the signatory countries including South Korea, Japan, Norway, the European Union, and the United States.

The vessel repair statute, enacted in 1866, imposes a 50 percent duty on the value of "expenses of repairs" made in a foreign country upon United States-flag vessels. (Act of July 18, 1866, 19 U.S.C. Section 1466 et seq.)

Under existing law, the vessel owner is required, upon first arrival of the vessel in the United States, to declare to the Customs Service all repair work done outside the United States. As part of the entry process, the vessel owner is required to estimate

the duties owed and then deposit the estimated amount of duties with the Customs Service.

This statute, designed to enforce the requirement that U.S. flag ships be repaired in U.S. yards, has been the subject of significant litigation over its 130-year history. Most recently, the provisions were confirmed and applied in the case of Texaco Marine Services v. United States.

Under other statutory authority, the privileges and requirements for "U.S.-flag" vessels are set forth. They include the requirement that such vessels be crewed with U.S. citizens, that the majority ownership be by U.S. citizens, that the ships be built and maintained to U.S. Coast Guard standard, and that the ships be repaired in U.S. yards. The ad valorem duty is, therefore, not designed as a revenue raising measure, but as an enforcement mechanism to achieve long-standing national policy objectives in support of maintaining a strong shipyard infrastructure in this country.

Throughout its 130-year history, these maritime policy objectives have been achieved in great measure due to the ad valorem duty. Through statute and regulation, the Congress and the Customs Service have from time to time modified the basic ad valorem duty, so as to facilitate necessary "voyage repairs" in case of emergency. In recent years, this and other exceptions, combined with the difficulty of enforcement, have significantly eroded the effectiveness of the ad valorem duty enforcement mechanism. The exceptions to the duty, including "voyage repairs," and the methods of calculating the dutiable repair work, have threatened to swallow the underlying principle. In fact, our Port has in the past sought Congressional initiative to strengthen these provisions, and to assure that truly 50 percent of the value of the foreign repair work was paid to U.S. Customs. Thus, the 50 percent duty is, often, something less than that.

Fortunately, the underlying concept of the duty has remained intact, and is, in fact, after the Texaco case, very much in place today. We believe this is as it should be.

Competition

The Portland Ship Yard, like all other ship repair yards in the United States, is competing on something less than a level playing field. We appreciate the efforts to eliminate massive subsidies by certain foreign governments to their shipyards. But even if and when these are eliminated under the Agreement, PSY and other U.S. yards will still face unequal competition, and arguably unfair competition as well.

U.S. shipyards must comply with stringent Federal and State labor regulations. We pay wages that can support families. We comply with significant environmental requirements. We comply with Occupational Safety and Health Administration regulation, inspection, and oversight. We provide health care, disability, vacation, and other benefits. This list goes on and on. Meanwhile, our foreign competitors, including those shipyards located in countries which are signatory to the Shipbuilding Agreement, do not face such costly demands. OSHA, retirement funds, health care benefits, environmental mandates do not characterize shipyard work in Korea, the location of the nearest competing shipyards of concern to PSY.

We can compete on a level playing field. For example, nearby Canadian yards are faced with similar labor, health, and environmental requirements. PSY contractors have competed successfully with these Canadian yards for cruise ship repair/maintenance business.

But many other foreign competitors are another story. Unless their governments impose the same requirements on their shipyards, or our government removes the regulatory burden on ours, there will be no level playing field.

The 50 percent ad valorem duty is the only means available to maintain a level playing field. The "invisible subsidies" which is how we would characterize the lack of regulatory burden on competing Asian shipyards, will remain in place even once the Shipbuilding Agreement becomes effective. But the Agreement would eliminate the only means we have to counter these "invisible subsidies."

Position

Our position is that the 50 percent ad valorem duty must remain in effect, at least considerably longer than the Agreement, as presently constituted, would allow.

Direct employment at PSY is more than 1,000 workers with family-wage jobs. Added to that total are workers employed by subcontractors at the yard. The Port of Portland cannot support an international agreement that puts these jobs at risk. We encourage Congress to call for re-negotiation of this agreement, taking into account the concerns listed in our statement.

Thank you for your attention to our views.

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August 1, 1995

Phillip D. Moseley
Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: *Legislation to Implement the OECD Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry: Comments on Article 1.3 and Annex III in response to TR-14 (June 28, 1995)*

Dear Mr. Moseley:

The House Ways and Means Committee is presently considering legislation to implement the terms of the 1994 Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry ["Shipbuilding Agreement"]. These comments are submitted on behalf of The Torrington Company and The Timken Company in response to the House Ways and Means Subcommittee on Trade's June 28, 1995 release, TR-14. The Timken Company and the Torrington Company are two of the nations largest bearing producers who have an active interest in the structure and implementation of U.S. trade laws.

These comments do not address all aspects of the Agreement, just the portion of the agreement which provides a basis for seeking "injurious pricing charges" [Article 1.3 and Annex III] -- a concept analogous to current antidumping duties under Title VII of the Tariff Act of 1930. It is understood that a number of amendments not part of existing U.S. antidumping law are being considered by certain members as part of the proposed legislation to implement the Shipbuilding Agreement: specifically these are understood to include (1) addition of a so-called "short supply" provision; (2) adoption of a "lesser duty" rule; and (3) use of a causation standard requiring the weighing of causes (i.e., a standard different from that used in existing unfair trade laws). It is respectfully submitted that there is no basis for the addition of any of the three provisions, even if limited to shipbuilding situations. Indeed, the very nature of the shipbuilding agreement renders the applicability of at least two of the proposed provisions moot. All of the proposals would also constitute a fundamental change in U.S. law and practice despite the fact that the Uruguay Round Agreements Act took effect only at the beginning of this year, and there is no factual basis for believing any of the issues should be revisited or handled differently in legislation that is meant to mirror existing international rights and obligations under Article VI of GATT 1994.

Antidumping provisions in the Shipbuilding Agreement

A comparison of the Shipbuilding Agreement and the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ["Antidumping Agreement"] reveals that the Shipbuilding Agreement adopted all relevant provisions of the Antidumping Agreement in terms of determining price discrimination, injury, causation, imposition of charges, judicial review and most other items. The main differences flow from the nature of the product (and whether it is viewed as entering commerce of purchasing countries) and the desire of the parties to the agreement to have separate complaints brought against each lost contract within limited time frames. The former difference results in "injurious

pricing charges" being charged to the offending shipbuilder (subject to cancellation or, if there is a failure to pay, countermeasures) and there being no provisional charges. E.g., Annex III, Article 7. The latter difference means that a range of provisions (e.g., sunset reviews; consideration of import trends, etc.) are not incorporated. Finally, a number of articles in the Antidumping Agreement are not incorporated which are not relevant to the issues being considered by the Committee (e.g., developing country provision; establishment of antidumping committee; dispute settlement under the Antidumping Agreement, etc.). The attachment to this write-up gives a more detailed analysis of how Annex III relates to the Antidumping Agreement.

"Short Supply" is not possible under the Shipbuilding Agreement

The issue of "short/no supply" was debated at length during the Uruguay Round Agreements Act deliberations last year. The arguments against adoption of a short/no supply provision remain valid and are reviewed briefly below. However, in the Shipbuilding Agreement, the structure of the agreement dictates that applications for relief cannot be filed where a domestic producer has not bid on the business and substantially met bid specifications (including delivery date and technical specifications). See Annex III, Article 5.2(d)(i), (ii) and (iii). Because the structure of the agreement applies a remedy only on the individual contract by design, by definition there can be no factual predicate for a country or opposing party arguing that the domestic industry/producer could not supply that which was covered by the contract. If a domestic producer/industry is found qualified to file the application, it must have demonstrated that it actively pursued the contract and was prepared to meet bid specifications and delivery timeframes. Failure to do so results in the application for an investigation being rejected. Stated differently, even for those who favor a "short/no supply" provision, there can be no situation under the Agreement where such a provision could have any role/relevance.

The arguments against adding a short supply provision to U.S. antidumping law that were raised during the Uruguay Round Agreements Act and a different causation standard remain valid and are supplemental reasons why such provisions should not be added to the Shipbuilding Agreement:

- o short supply does not exist and cannot be caused by laws whose only effect is to impose offsetting duties for subsidization or price discrimination; product remains available, just at *unsubsidized* or undumped levels;

- o short supply provisions reward foreign producers who have prevented U.S. companies from continuing to produce or beginning to produce particular products;

- o in a market economy, short supply provisions would deny U.S. producers the market signals (i.e., where prices under conditions of fair trade go) to determine whether to enter or reenter production;

- o short supply provisions ignore the reality of duty absorption by many foreign producers that has been documented as a continuing problem in the U.S.; hence, in many situations, foreign prices are not increased at all or fully even with the imposition of dumping duties -- another manifestation that the issue is a red herring.

"Lesser Duty" Rule

Under Article VI of the 1994 GATT and the Antidumping Agreement, countries may assess dumping duties that are less than the full amount of the price discrimination found to exist if such will result the

neutralization of the injury. The United States, under both Republican and Democratic Administrations, has opposed any modification to the language of what is now Article 9.1 of the Antidumping Agreement which preserves the right of the United States to impose duties to offset the full amount of the duties.* Moreover, under U.S. law, where dumping liability is determined on an annual review basis based on new importations, the lesser duty rule (even if viewed as acceptable policy on a theoretical level) would be administratively burdensome as any decision of amount of injury to be offset would presumably have to be reevaluated at the time of each review.

The Shipbuilding Agreement contains identical language to Article 9.1 of the Antidumping Agreement in Article 7.1 of Annex III [Art. 9.1 of GATT 1994 Antidumping Agreement ("the decision whether the amount of the anti-dumping duty to be imposed shall be the full margin of dumping or less, are decisions to be made by the authorities of the importing Member") vs. Article 7.1 of Annex III ("the decision whether the amount of the injurious pricing charge to be imposed shall be the full margin of injurious pricing or less, are decisions to be made by the authorities of the investigating Party")]. Thus, there is no reason based on the language of the Shipbuilding Agreement to deviate from what is existing law and practice in Title VII.

Moreover, in the Shipbuilding Agreement the imposition and collection of injurious pricing charges is against the foreign shipbuilder, not the customer (i.e., importer) as is the case in the Antidumping Agreement and under U.S. law. Article 7.3 of Annex III. The purpose of the charge seems to be primarily to force the shipbuilder to void the contract [Article 7.4(1) of Annex III] in which case no charge is required or to develop an "alternative equivalent remedy accepted by the investigating authority". Indeed, providing the ability to require payment of the charge by the shipbuilder acts mainly as a stick to encourage compliance by shipbuilders with the international obligations. It is unlikely that the shipbuilder would be able to pass any of the charge on to its customer. In such a situation, it is unclear what policy objective would be achieved by not having U.S. law require the full charge. The full charge is likely to promote both the reopening of contracts (presumably the best possible end result) and leveraging other remedies acceptable to the U.S. (and presumably our shipbuilding industry). Thus, the very structure of the Shipbuilding Agreement indicates that no "lesser duty" provision should be added to U.S. implementing legislation.

Causation

Article 3 of the Shipbuilding Agreement's Annex III uses generally identical language to Article 3 of the Antidumping Agreement, with the major exceptions being the elimination of an evaluation of the volume and trend of imports, reflecting the focus of the investigation on the particular lost contract. The causation paragraph in Annex III (Article 3.5) is identical in all material language to Article 3.5 of the Antidumping Agreement. There is nothing within the Shipbuilding Agreement to suggest the need for a different construction of the same language contained in the Antidumping Agreement. The Statement of Administrative Action to the Uruguay Round Agreements Act indicates that existing U.S. law and practice is consistent with the requirements of Article 3.5 of the Antidumping Agreement (and its predecessor in the 1979 Antidumping Code):

> "Article 3.5 of the Antidumping Agreement and 15.5 of the Subsidies Agreement do not change the

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* Existing U.S. antidumping law has, since 1980, permitted a suspension agreement to be entered which did not result in the total elimination of the dumping margins where all injury and price suppression effects are eliminated in "extraordinary circumstances". 19 U.S.C. § 1673c(c). Under the Shipbuilding Agreement, the foreign shipbuilder can avoid the duty altogether by voiding the contract. Annex III, Article 7.4.

> causation standard from that provided in the 1979 Tokyo Round Codes. Existing U.S. law and legislative history fully implement the causation standard of the "1979 Codes. Thus, existing U.S. law fully implements Articles 3.5 and 15.5. Articles 3.5 and 15.5 do include new language requiring WTO signatories to 'examine all relevant evidence' including 'any known factors, other than the dumped [or subsidized] imports which at the same time are injurying the domestic industry.' The obligations embodied in the new language are reflected in the existing statute and legislative history.
>
> "The GATT 1947 Panel Report in the Norwegian Salmon case approved U.S. practice as consistent with the 1979 Codes. The panel noted that the Commission need not isolate the injury caused by other factors from injury caused by unfair imports. See GATT Committee on Anti-dumping Practices, United States -- Imposition of Anti-dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway: Report on the Panel Par. 555 (Nov. 30, 1992); GATT Committee on Subsidies and Countervailing Measures, United States -- Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway: Report "on the Panel Par. 321 (Dec. 4, 1992). Rather, the Commission must examine other factors to ensure that it is not attributing injury from other sources to the subject imports."

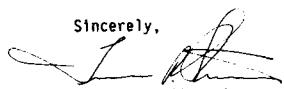
Message from the President of the United States Transmitting the Uruguay Round Trade Agreements, Texts of Agreements Implementing Bill, Statement of Administrative Action and Required Supporting Statements reprinted in House Doc. 103-316, Vol. 1 at 851-852 (1994).

Congress has mandated that the Statement of Administrative Action "shall be regarded as an authoritative expression by the United States concerning the interpretation and application of the Uruguay Round Agreements and this Act in any judicial proceeding in which a question arises concerning such interpretation or application" [19 U.S.C. § 3512(d)]. Since the Uruguay Round Agreements Act took effect on the antidumping amendments generally on January 1, 1995, there has not been the accumulation of case experience or Commission construction to warrant a reexamination of the construction viewed by Congress as controlling.

Moreover, where weighing of causes has been required (i.e., escape clause actions where no subsidization or price discrimination has been alleged or found), relief has seldom been available regardless of the problems being experienced. There is no justification for increasing the hurdle to relief (indeed, more than half of the cases filed with the ITC have resulted in negative injury determinations under the existing standard). If anything, the Committee should be reviewing the existing standard to see if it likely to be obtainable on a contract by contract basis as is contemplated by the Shipbuilding Agreement.

On behalf of our clients, I appreciate the opportunity to present views on the above limited issues.

Sincerely,



Terence P. Stewart

Attachment

Attachment

Comparison of Annex III to the Shipbuilding Agreement with Article VI of GATT 1994 and the Antidumping Agreement

In the Preamble to the Shipbuilding Agreement, there is a recognition that some forms of unfair trade cases may face particular obstacles in the WTO under Article VI and the subsidies and antidumping agreements:

> Recognizing also that special characteristics of ship purchase transactions have made it impractical to apply countervailing and anti-dumping duties, as provided under Article VI of GATT 1994, the Agreement on Subsidies and Countervailing Measures, and the Agreement on the Implementation of Article VI of GATT 1994.

Article 1.3 of the Shipbuilding Agreement recognizes the need to provide a remedy to injurious price discrimination and does so via Annex III. Specifically, Article 1.3 states that --

> 3. The Parties recognise that the sale of commercial ships at less than their normal value is to be condemned if it causes or threatens material injury to an established shipbuilding and repair industry in the territory of another Party, or materially retards the establishment of a domestic shipbuilding and repair industry. In order to remedy or prevent such injurious pricing, Annex III is applicable.

This language parallels the basic teaching of Article VI.

In most respects, Annex III is identical to Article VI of the GATT 1994 and its Annex I and the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994. Thus, for example, Annex III is divided into three parts: A. Basic Principles; B. Supplementary Provisions Regarding the Basic Principles; and the Shipbuilding Injurious Pricing Code.

The first part of the Annex has the following relationship to Article VI of the GATT 1994:

Annex III, Basic Principles	GATT 1994, Article VI
Paragraph 1 is similar to	Paragraph 1, first sentence
Paragraph 2 is similar to	Paragraph 2, first sentence
Paragraph 3 is similar to	Paragraph 4
Paragraph 4(a) is similar to	Paragraph 6(a)
Paragraph 4(b) is similar to	Paragraph 6(b)
Paragraph 5 is new.	

Paragraph 5 of the Shipbuilding Agreement commits the parties to take action only under the Annex. Parties also agree to withhold action if an antidumping action under the GATT 1994 is brought by a WTO member not a party to the Shipbuilding Agreement. Parts of Article VI of the GATT 1994 not included in the Basic Principles of the Shipbuilding Agreement essentially deal with countervailing duties or are handled through the detailed provisions of the Shipbuilding Injurious Pricing Code.

Similarly, the Supplementary Provisions Regarding the Basic Principles mirror the language contained in Annex I to GATT 1994 on Article VI. There is only one note to Article VI which is not picked up in the Shipbuilding Agreement. Specifically, Note 1 to paragraphs 2 and 3 of Article VI of GATT 1994 is not repeated in the Shipbuilding Agreement since bonds or cash deposits are not contemplated in the Shipbuilding Agreement. But notes one and two to paragraph 1 of the Shipbuilding Annex III are the same as notes one and two paragraph 1 of Article VI of GATT 1994. The note to paragraph 2 of the Shipbuilding Annex III is the same as note 2 to paragraphs 2 and 3 of Article VI of GATT 1994 (with the deletion of material relevant to countervailing duty actions). The note to paragraph 4 b) of the Shipbuilding Annex III is the same as the note to paragraph 6(b) of Article VI of GATT 1994.

Shipbuilding Injurious Pricing Code
vs. Antidumping Agreement

A review of the Shipbuilding Injurious Pricing Code demonstrates that it copies verbatim all parts of the Antidumping Agreement viewed as relevant. The differences flow from the focus of the injurious pricing code on handling lost contracts as they occur and limiting relief to the particular lost sale. Thus, the Shipbuilding Code:

- o has a preamble section that is not found in the Antidumping Agreement,
- o does not contain provisions calling for provisional relief or for undertakings (Articles 7 and 8 of the Antidumping Agreement) since the exporter is not reachable through bonds and the ultimate relief would be a voiding of the contract,
- o does not contain provisions permitting retroactivity or dealing with sunset reviews (Articles 10 and 11 of the Antidumping Agreement) since Shipbuilding cases are contemplated for specific lost sales contracts,
- o does not provide special and differential treatment for developing countries (only Korea is arguably a developing country in the Shipbuilding Agreement)(Article 15 of the Antidumping Agreement), and
- o does not separately provide for a special committee, dispute settlement special to injurious pricing or have "final provisions" (Articles 16 - 18 of the Antidumping Agreement).

For all material provisions of the calculation of injurious pricing, injury, causation, procedures, verification and use of information, the Shipbuilding Injurious Pricing Code is identical to the Antidumping Agreement. Below is a shorthand comparison of the main provisions.

Shipbuilding Injurious Pricing Code		Antidumping Agreement
Art. 1.1	=	Art. 1
Art. 1.2 = new ["The Parties agree to incorporate into this Code any amendments made in the future to the Agreement on the Implementation of Article VI of GATT 1994. Changes to such amendments shall be limited to those necessitated by the special characteristics of commercial shipbuilding."]		

Shipbuilding Injurious Pricing Code		Antidumping Agreement
Art. 2.1	=	Art. 2.1
Art. 2.2	=	Art. 2.2
Art. 2.2.1 except recovery of cost = 5 yrs vs.	=	Art. 2.2.1 normally 1 year
Art. 2.2.2 except new "(iv)"	=	Art. 2.2.2
Art. 2.2.3 = new (special exception for certain extraordinary circumstances because of long lead time for ships)		
Art. 2.3	=	Art. 2.3
Art. 2.4	=	Art. 2.4
Art. 2.4.1	=	Art. 2.4.1, first sentence
Art. 2.4.2	=	Art. 2.4.2
Art. 2.5	=	Art. 2.5
Art. 2.6 (like vessel)	=	Art. 2.6 (like product)
Art. 2.7	=	Art. 2.7
Art. 3.1	=	Art. 3.1 minus "the volume of dumped imports"
Art. 3.2	=	Art. 3.2 minus first sentence (on volume of imports)
Art. 3.3	=	Art. 3.3 minus "and the volume of imports from each country is not negligible"
Art. 3.4	=	Art. 3.4
Art. 3.5	=	Art. 3.5
Art. 3.6	=	Art. 3.6
Art. 3.7	=	Art. 3.7 minus (i) and (iv) dealing with increased rate of imports and inventories
Art. 3.8	=	Art. 3.8
Art. 4.1	=	Art. 4.1 minus (ii) on regional industry
		Art. 4.2 dealing with regional industries is deleted
Art. 4.2	=	Art. 4.3
		Art. 4.4 is deleted
Art. 5.1	=	Art. 5.1

Shipbuilding Injurious Pricing Code		Antidumping Agreement
Art. 5.2 shipbuilding code has timing requirement for filing application after a contract has been lost; has a standing requirement that applicant has bid on contract; information in the application is largely the same	=	Art. 5.2, plus
Art. 5.3	=	Art. 5.3
Art. 5.4	=	Art. 5.4
Art. 5.5	=	Art. 5.5
Art. 5.6 conformed for standing requirement	=	Art. 5.6
Art. 5.7	=	Art. 5.7 minus the last clause
Art. 5.8	=	Art. 5.8 minus negligle imports
		Art. 5.9 is deleted (customs clearance)
Art. 5.9	similar	Art. 5.10 (time for doing investigation)
Art. 6.1 findings of any inv. by exporting country	=	Art. 6.1 plus
Art. 6.1.1	=	Art. 6.1.1
Art. 6.1.2	=	Art. 6.1.2
Art. 6.1.3	=	Art. 6.1.3
Art. 6.2	=	Art. 6.2
Art. 6.3	=	Art. 6.3
Art. 6.4	=	Art. 6.4
Art. 6.5	=	Art. 6.5
Art. 6.5.1	=	Art. 6.5.1
Art. 6.5.2	=	Art. 6.5.2
Art. 6.6	=	Art. 6.6
Art. 6.7	=	Art. 6.7
Art. 6.8	=	Art. 6.8
Art. 6.9	=	Art. 6.9
		Art. 6.10 deleted (individual margins)
Art. 6.10	=	Art. 6.11

Shipbuilding Injurious Pricing Code		Antidumping Agreement
Art. 6.11	=	Art. 6.12 plus "and the elements set out in Art. 5.2(d)"
Art. 6.12	=	Art. 6.13
Art. 6.13	=	Art. 6.14
Art. 7.1	=	Art. 9.1
		Art. 9.2 deleted (collection of duties on non-discrim. basis)
Art. 7.2	=	Art. 9.3
		Art. 9.3.1, 9.3.2 and 9.3.3 deleted (prospective and retrospective systems for collection)
Art. 7.3 = new (collection from shipbuilder)		
Art. 7.4 = new (when obligation to pay expires)		
Art. 8.1	=	Art. 12.1 + 12.1.1
Art. 8.2	=	Art. 12.2+12.2.1+12.2.2, deleting information on provisional duties
		Art. 12.3 deleted (which related to Articles 10 and 11)
Art. 9	=	Art. 13
Art. 10.1	=	Art. 14.1
Art. 10.2	=	Art. 14.2
Art. 10.3	=	Art. 14.3
Art. 10.4 fn. indicates approval by consensus minus the exporting Party	=	Art. 14.4
Addendum I	=	Annex I
Addendum II	=	Annex II (with minor modifications)

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United States Council for International Business

ABRAHAM KATZ, President

Serving American Business as U.S. Affiliate of

The International Chamber of Commerce
The International Organisation of Employers
The Business and Industry Advisory Committee to the OECD
The ATA Carnet System

July 14, 1994

The Honorable Philip M. Crane
Chairman, Subcommittee on Trade
House Committee on Ways and Means
233 Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Crane:

I am writing on behalf of the U.S. Council for International Business to express strong support for the OECD Shipbuilding Agreement and, in light of the July 18 hearing by the House Subcommittee on Trade, to urge Congress to move expeditiously to produce implementing legislation that fulfills the spirit of the Agreement.

As the U.S. affiliate to the Business and Industry Advisory Committee (BIAC) to the OECD, the U.S. Council has followed the talks leading to this Agreement closely over the past five years, pressing for a consensus on limiting shipbuilding subsidies. Following the successful conclusion of the Agreement in 1994, we expressed our support for its full implementation to Ambassador Kantor. The U.S. Council looks forward to commenting on the implementing legislation once it is made available.

Dedicated to an open system of world trade, finance and investment, the U.S. Council represents approximately 300 major multinational corporations, service companies, law firms, and business associations. In addition to its role in BIAC, the U.S. Council is the U.S. affiliate of the International Chamber of Commerce and the International Organization of Employers. Our members benefit directly from open competition and the elimination of distortions in international trade. The OECD Agreement goes a long way toward meeting those ends and will benefit both the international trading regime and the U.S. maritime industry.

Thank you for taking the time to consider our opinions. We look forward to providing you with further input in the future.

Sincerely,

Abraham Katz

CC: Phillip D. Mosely
Majority Chief of Staff
House Committee on Ways and Means

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IMPLEMENTATION OF URUGUAY ROUND AGREEMENTS AND THE WORLD TRADE ORGANIZATION

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

MARCH 13, 1996

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IMPLEMENTATION OF URUGUAY ROUND AGREEMENTS AND THE WORLD TRADE ORGANIZATION

WEDNESDAY, MARCH 13, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:12 a.m., in room 1100, Longworth House Office Building, Hon. Philip M. Crane (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
February 7, 1996
No. TR-18

CONTACT: (202) 225-1721

Crane Announces Series of Hearings on Trade Policy: First Hearing to Address Implementation of Uruguay Round Agreements and WTO

Congressman Philip M. Crane (R-IL), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, today announced that the Subcommittee will hold a series of hearings throughout 1996 on the status and future direction of U.S. trade policy. In these hearings, the Subcommittee intends to address the form and content of future trade policy initiatives as the United States approaches the 21st century. It will also examine issues such as possible new trade agreements, implementation of, compliance with, and progress made thus far in existing trade agreements, and the impact of freer trade on wages, economic opportunity, and U.S. competitiveness. Finally, the hearings will review past major trade agreements to which the United States has been a party.

The first hearing in this series will take place on Wednesday, March 13, 1996, at 10:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building, and will address implementation of the Uruguay Round Agreements, including the establishment of the World Trade Organization (WTO). Additional hearing days in the series will be scheduled at a later time.

Oral testimony at the hearings will be heard from both invited and public witnesses.

BACKGROUND:

The Uruguay Round Agreements were approved by Congress in late 1994 and entered into effect on January 1, 1995. These agreements are the broadest, most comprehensive multilateral trade agreements in history. They cut global tariffs by one third and reduce or eliminate numerous nontariff measures, such as quotas, restrictive licensing systems, and discriminatory product standards. They also contain multilateral rules covering such matters as technical barriers to trade, trade-related investment measures, rules of origin, import licensing procedures, safeguards, trade-related aspects of intellectual property rights, antidumping/countervailing duties, agricultural trade, and government procurement. In addition, the General Agreement on Trade in Services establishes a framework of rules for trade and investment in services sectors, including most-favored-nation and national treatment, market access, transparency, and the free flow of payments and transfers.

The Uruguay Round Agreements also established the WTO as the successor organization to the General Agreement on Tariffs and Trade to implement the Agreements internationally, resolve disputes, and conduct future negotiations. Since the WTO went into effect, there have been continuing negotiations on certain services negotiations under the auspices of the WTO, including financial services, basic telecommunications services, and maritime services. Trade ministers from WTO member countries will meet in Singapore in November of this year to assess the status of world trade under the WTO and to consider topics for future negotiation.

In announcing the hearings, Crane said: "The signing of the Uruguay Round Agreements was an historical event in which over 100 countries agreed to strip down barriers to free and open trade, including in areas that had never before been the subject of such multilateral rules. The importance of these Agreements is that they represent an opportunity for the United States to enjoy lower barriers abroad and trade reciprocity with other signatories, creating significant benefits for the U.S. economy and U.S. businesses and workers. Now that the Agreements have been in place for over a year, we should begin to assess how they have been functioning, the progress made to date, and whether problems have arisen that deserve further attention by the Subcommittee. Now is also a good opportunity for us to begin to look toward the future and determine what our next trade policy goals and objectives within the WTO should be and how best to accomplish them. In future hearings, I hope to review the status of, and prospects for, other U.S. trade initiatives. The Asia Pacific Economic Cooperation (APEC) forum is but one example of subjects the Subcommittee will consider. APEC may well define the framework for future trading relationships between the United States and the fast-growing Asian region. I believe it is important to examine how APEC is proceeding and what our goals should be through this important forum."

FOCUS OF THE HEARINGS:

The hearing will examine the implementation of the Uruguay Round Agreements and the WTO, the progress made thus far in their first year of operation, and prospects for the future. Issues such as the economic and business benefits of various aspects of the Agreements and the WTO will be assessed, as well as the status of implementation. In addition, the objectives of the ongoing services negotiations will be addressed by the Subcommittee. The Subcommittee will also consider the WTO's dispute settlement mechanism, both as it relates to U.S. sovereignty and as it provides an opportunity for the United States to challenge actions by trading partners.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearings must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business on Friday, March 1, 1996. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Trade will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-6649.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearings. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. The full written statement of each witness will be included in the printed record.

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. Testimony should arrive at the Subcommittee on Trade office, room 1104 Longworth House Office Building, no later than close of business on Monday, March 11, 1996. Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearings should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business on Friday, March 29, 1996, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearings, they may deliver 200 additional copies for this purpose to the Subcommittee on Trade office, Room 1104 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

******

Chairman CRANE. Good morning. The Trade Subcommittee begins a series of hearings on the status and future direction of U.S. trade policy.

Ambassador Kantor and Ambassador Clayton Yeutter have joined us this morning to review implementation of the Uruguay Round Trade Agreement and the activities of WTO, the World Trade Organization, since it was established on January 1, 1995.

As my colleagues know, I am a strong supporter of the WTO, and I am committed to ensuring that the United States lends its full support to getting an effective WTO body up and running.

As others have pointed out, the early days of any institution's life are critical to its future credibility and effectiveness. A WTO that works well will keep watch to ensure that job-creating U.S. exports are receiving fair access to 120 nations around the world. The United States wins with fair rules promoted by an institution that has the moral authority to ensure they are followed.

This is not to say our own practices will always receive a clean bill of health. As we have seen with the decision on reformulated gasoline, our participation in a smoothly functioning trading system requires that we play by the same fair rules we have insisted upon on the part of our trading partners.

I am convinced Americans instinctively understand principles of fair play and will accept these occasional adverse decisions in stride. As the world's greatest exporter, the benefits of adhering to the commonsense ground rules of the WTO, such as national treatment and nondiscrimination, will be enormous for the United States.

I expect the distinguished witnesses with us today will speak to the great opportunities for U.S. workers and industry which were put in place by the Uruguay Round Agreement.

Ambassador Kantor, as you well know, the USTR congressional partnership is key to our success in this exciting new endeavor. We are here to work with you, and I urge you to respect the need to develop a U.S. consensus on the issues we pursue internationally, and I look forward to your testimony today on these important topics.

I think with that, Mr. Kantor, we might proceed with your testimony, and as soon as our Ranking Minority Member arrives after your testimony, I am sure he has got some welcoming comments, too.

STATEMENT OF HON. MICHAEL KANTOR, U.S. TRADE REPRESENTATIVE

Ambassador KANTOR. Thank you very much, Mr. Chairman.

If I might, I would like to submit my full testimony for the record, and then just briefly summarize it, so the Subcommittee can have as much time as possible to ask questions and to make observations.

I thank you, Mr. Chairman, for what you said in your statement about working together in a bipartisan spirit. Trade policy works best and only works, frankly, when we have a bipartisan approach to what we are trying to accomplish in terms of fair trade, opening markets, leveling the playingfield, making sure that people play by the rules.

I appreciate your personal support, as well as this Subcommittee on both sides, over the last 37 months because I think we have made, as the administrations before us, progress in this area, and in fact, if you might, I would walk over to the charts and show we have made substantial progress in that regard.

If I could, Mr. Chairman, I would like to move over to the charts just for a brief couple of minutes to give an indication of where we are and what our potential is in trade, and I think by doing that, we also indicate exactly what our challenges are over the next number of years. With the Chair's permission, I would like to do that.

Thank you very much, Mr. Chairman.

First of all, I would like to show how important trade has become to the U.S. economy, and it is nothing short of astounding what has happened since 1970. This is Democrat and Republican administrations, and it has been a bipartisan effort, but it has been incredibly impressive.

If you look at 1970, trade represented about $132 billion in our economy, or about 13 percent of our gross product. This year, at the end of 1995—or in 1995—I keep forgetting we are in 1996—trade now represents a little over 30 percent of our economy, or $2.2 trillion. This involves goods. It involves services. It involves investment.

All of that means, as trade becomes more important, it is the recognition of four essential facts we have been talking about in this post-cold war world we are dealing with.

One, we must make sure our domestic economy remains strong and gets stronger in order to compete in the world and win.

Two, that trade is the way we link ourselves to nations in this post-cold war world, and it has taken its place at the foreign policy table.

Three, we are globalized and interdependent, whether some folks like it or not. I know all of you recognize it. You deal with it every day, as I do, but increasingly, these numbers indicate we are tremendously globalized and interdependent, and it has only become more so over the next number of years.

Last, of course, is that trade has become critical to our economy. When you have almost 12 million people, Mr. Chairman, involved strictly in the exporting of goods in the United States alone, you see what effect it has on the American worker.

We have some numbers on automobile production and employment, and imports that are also stunning, over the last 3 years, which I will get to in 1 second, but this affects jobs, it affects our standard of living, it affects the way in which we live in this country, and we have to make sure we continue to break down barriers, increase our exports of goods and services, not retreat, not retreat from a world that is going to be interdependent and globalized, as I said.

The second chart indicates what has happened over the last 3 years as we have reached 200 trade agreements, over 200 now, 188 principally negotiated by USTR, over 37 months, and what has happened to the import trend and the export trend.

As you can see, the export trend is going in the right direction. The import trend is beginning to flatten out. For the first time in

years, Mr. Chairman and Members of the Subcommittee, our percentage increase in exports exceeded our percentage increase in imports for the first time in goods, as well as overall.

Our percentage increase in goods was 14.7 percent, and imports was 12.4 percent, and that is a big change over the last number of years, and it is good news for American workers and American business, as we try to grow jobs, our standard of living, and increase capital.

I might note this 1995 was a record year. We increased our exports of goods by $72 billion. We have never come close to that before, and I think it is a testament to a bipartisan trade policy, as well as the competitiveness and productivity of U.S. workers and the aggressiveness of U.S. businesses in, as I said, a globalized economy.

Last, of course, is to look at what is our future and where growth is going to occur and what has happened in terms of how this world is changing.

Let me try to get out of the way because some important part is over here on the right side of the chart. That is not a political statement, just a fact.

Future export growth is going to occur, as it started to grow from 1985 to 1994 in what we call the emerging economies, big emerging markets of Asia and Latin America.

Just look what has happened in terms of merchandise export growth from 1985 to 1994. Our exports to Asia, outside of Japan, have grown by 214 percent; our exports to Latin America have grown 198 percent. Just look, it goes down to 108 percent for the European Union, we have had the slowest growth.

Now, that only makes sense. As the developed countries become mature economies and grow slower, which is a fact of life, and they have a smaller population growth or some of it is almost a zero population growth and have a slower growing labor force, obviously, their markets will not be growing as fast as those of Asia and Latin America.

By the year 2010, it is estimated that the combination of Asia, outside of Japan and Latin America, including Mexico, will be over one-half—over one-half of our exports.

That being the case, you can understand why this administration, this Congress, and this Subcommittee have paid so much attention to things like the Asian-Pacific Economic Cooperation Forum, the Free Trade Area of the Americas, and our bilateral relations, whether it is Japan or China or the ASEAN nations or working with Chile or working with Mercosur which involves, of course, Brazil, Paraguay, Uruguay, and Argentina.

All of those are important, tremendously important to our future. So we can see how trade has grown, too. We see what the import and export trends are, and now we see what our potential is.

The reason I went through that first, and not to take too much time, but to make sure we understood how important the WTO and Uruguay Round has been not only to our growth, but to our future, it sets a baseline of rules under which we can do one thing. We can break down barriers for U.S. goods and services and investment going into other economies. We can level the playingfield.

The most important aspect of the Uruguay Round was not the fact—although important, we reduced tariffs by over a third across the board, but we have a Dispute Settlement Understanding that works and is working well and I will be glad to talk about, or that we have covered agriculture and covered intellectual property and services for the first time which, of course, does make a big difference, but the fact that after a 10-year phase-in at the most, 5 years for most, every country in the world, at least at the base, will be playing by the same rules.

The United States had an open market, the largest in the world. We used trade as a political tool, as we should have, in the cold war to build the economies of our allies, but what we didn't do is make the rules fair once the situation changed in order to not only build jobs and standard of living here, but to make sure—get our products into these foreign markets, grow capital, and increasingly have money for investment in our economy.

The Uruguay Round at its base, that is the most important factor of all, and it has been a principle we have tried to live up to in every agreement we have reached.

I think President Clinton said it best on February 26, 1993, at American University. He said, "We welcome the goods and services of other nations as they come into our market, but we insist that we have equal access to their market as well." I think that is a principle that we all share and continue to work toward.

I would be delighted to address issues such as this question of sovereignty in the Uruguay Round or the WTO—in which I think it has been protected, and protected well—to talk about the Uruguay Round's contribution, let us say, to agriculture, where we have grown 28 percent in agricultural exports in the first year alone of the Uruguay Round, which I think is enormous. Enormous credit goes to our agricultural community for being productive and competitive, but also to the way the Round ensured for minimum access, current access, and tariffication, and allowed us to have more access to these markets.

Second, of course, if you look at what happened in our zero-for-zero categories, of which there were 10—I know Hank Barnette will be up here later and talk about this—we have doubled in the first year of the Uruguay Round our export of steel from the United States. Now, as all of you know, that is a historic change in what was happening to that industry.

Second, we have raised, for instance, our—I am trying to remember—30 percent higher for paper, 30 percent higher for construction equipment, all zeros for zeros. So we can say this. If we reduce these barriers, we do better and better.

American workers can compete. Our companies can compete if we stick to the principle of leveling the playingfield.

There are priorities with the WTO as we look ahead toward the Singapore Ministerial, and late this year—I think it is December 9–13, 1996—everything from making sure we continue to open access to markets by lowering tariffs, and hopefully, an Information Technology Agreement will come out of that which would get rid of tariffs in those critical sectors such as computers and software, that we are able to deal with issues such as bribery, corruption, trade, and labor.

We will have a report from the Trade and Environment Committee. We would like to deal with antitrust policy or failure to exercise or to enforce laws regarding antitrust or anticompetitive behavior in various critical economies, and look at how we can do better in protecting investment in foreign economies as we protect it here.

The agenda of the WTO is large. It is working well.

Let me make one other comment. This comes up from time to time with international organizations, and I think we ought to try to understand just how frugal this organization is.

Our contribution to WTO is $13.7 million. Frankly, it is dwarfed by our contributions to almost every other international organization to which we belong. This is a contract organization. We are not the largest contributor. It is based upon your total trade. The European Union is the largest contributor.

It is also an organization that has, I think, operated very well. They have increased their staff only a minimal amount since the GATT became the WTO, given the new responsibilities, and I believe it is an organization that has operated, frankly, in a very frugal and responsible manner.

The fact is that that small contribution has helped to create a situation in which we are the big winners, as I have indicated, and will continue to be. I hope we can have an administration and bipartisan continuing effort to strengthen the organization to make sure the rules are fair, to make sure we use a dispute settlement mechanism in the appropriate way.

Again, Mr. Chairman, let me say I appreciate not only your support, but the support of all the Members of this Subcommittee as we continue to work toward these goals.

[The prepared statement and attachments follow:]

STATEMENT OF HON. MICHAEL KANTOR
U.S. TRADE REPRESENTATIVE

Mr. Chairman, it is a pleasure to appear before this Committee today to discuss the World Trade Organization and its first year of operation. U.S. leadership in maintaining a vibrant, open and fair trading system is essential to sustainable global growth and economic prosperity here at home. The Administration is committed to ensuring that open markets and fair trade rules work to the benefit of American workers and companies -- without infringing on U.S. sovereignty. The WTO is good for America and all our citizens.

Mr. Chairman, creation of the WTO and completion of the Uruguay Round Agreements ensured U.S. leadership in the global economy. The history of the 20th century is clear: global peace and prosperity depend on U.S. leadership. In the aftermath of World War II, the United States led the world on a path of increased growth, stability and trade expansion. We made a decision to engage in the world, and not withdraw as we did after World War I or repeat the disastrous mistake of the Smoot-Hawley Act. We led in the creation of international institutions that fostered growth and stability and met the challenges of those times. A half century of global prosperity is the legacy of our leadership during the post-World War II reconstruction, and during the Cold War.

Now, in the post-Cold War era, at a time of tremendous changes in the world, the need to continue our global economic leadership is greater than ever. By writing a set of fair trade rules for this new era, the Uruguay Round is -- and has already proven to be -- critical to our efforts to create jobs and foster growth in the United States.

U.S. leadership was critical to concluding the Uruguay Round. President Clinton, realizing the Round was essential to efforts to grow jobs and create fair trade, led the effort to reinvigorate the negotiations and to break the gridlock that had stalled agreement despite several years of preparation and another seven years of negotiation. In an important demonstration of bipartisan commitment and determination, the Congress approved the results of the negotiation and establishment of the WTO in the Uruguay Round Agreements Act (URAA). President Clinton signed the URAA on December 8, 1994, and the WTO entered into force on January 1, 1995.

I'm pleased to report to you that one year later, all the hard work and effort is paying off. But, our work has just begun. We will continue to give the highest priority to full and effective implementation of the Uruguay Round Agreements. Often called the WTO's "built-in agenda," this includes the substantial work programs and negotiations already required by the Uruguay Round Agreements. But, to continue U.S. leadership in the global economy, we must anticipate new opportunities and make progress toward sustainable development.

The Importance of Global Trade to the U.S. Economy

The Administration, with the bipartisan cooperation of Congress, has always had as its goal more opportunities to sell our goods and services in foreign markets by breaking down barriers to trade. The means toward that goal have been to enter into agreements which open new markets to U.S. exports, and monitor and enforce those agreements, utilizing U.S. trade laws where necessary, to ensure that our trading partners are living up to their obligations.

The key to this, as the President said in a speech at American University in February 1993 when he outlined his trade policy, is to "continue to welcome foreign products and services into our markets, but insist that our products and services be able to enter theirs on equal terms." He knows that if we can level the playing field, the American worker will do the rest. The stronger multilateral system created by the Uruguay Round is part of this effort.

Moreover, the system of multilateral rules provides a foundation for our efforts around the globe, whether it is the FTAA, APEC or the Transatlantic Marketplace. In turn our regional efforts aid

our efforts for more open markets by creating new mechanisms which pressure our trading partners to keep pace with the progress recorded in regional fora. Clearly, the regional agreements must be consistent with WTO rules, and that has been a long-standing policy of the United States, while providing new opportunities to tear down barriers to trade of goods and services.

Bilateral and regional progress will lead inevitably to stronger and more effective multilateral rules. Indeed, the WTO Secretariat recently issued a study on regionalism and the world trading system, which concluded that regional integration agreements and the world trading system have generally functioned as complements to one another. In fact, the study recognizes that work done in the NAFTA on services actually helped to lay the foundation for the eventual Uruguay Round Agreement in this area. Taken together, our bilateral, regional and multilateral efforts all have the same goal -- open markets and fair trade rules for U.S. workers and companies.

Mr. Chairman, we are moving in the right direction. Here at home, all of our trade efforts are beginning to pay off. In 1995, we enjoyed the largest dollar volume of export growth in U.S. history. American workers and companies are once again the most competitive and productive in the world . We've surpassed the Germans in exports, and the Japanese in automobile production. Exports have grown at a record pace since President Clinton entered office, creating more than one million new jobs. And we're beginning to crack open Japan's long-closed market. According to Japan's own figures, the U.S. trade deficit with Japan reached its lowest point in twelve years in January.

Clearly, we are on the right course.

The Uruguay Round Agreements were a critical step in ensuring that Americans can compete and win in what the President calls an "Age of Possibility." We live in a world where the only constant is change. But President Clinton is committed to accepting the challenge of change. That's why he recognized -- and acted on -- four new realities which are shaping our world.

First, our nation's economic strength begins at home. With the President's leadership, a tough and far-reaching economic package was enacted, which lowered taxes for millions of Americans, helped to lower interest rates, cut the deficit dramatically and aided the successful fight on inflation. The economy has created 8.4 million jobs and 93 percent of those jobs have been in the private sector. In February 1996, unemployment was 5.5 percent. We're reducing the size and scope of government so that it creates opportunity, not bureaucracy.

Second, globalization and interdependence of the economies of the world are here to stay. Nostalgia for a time when the U.S. economy was self-contained is understandable, but it doesn't provide any answers for how to create jobs in the new economy. The nations of the world are truly interdependent.

Third, in the post-Cold War world, trade has taken its place at the foreign policy table, alongside strategic and political concerns. The days of the Cold War, when we sometimes looked the other way when our trading partners failed to live up to their obligations, are over. National security and our national economic security cannot be separated.

Finally, trade is more important than ever to the U.S. economy. In 1970, the value of trade equaled just 13 percent of the value of U.S. GDP. In 1995, that figure was an estimated 30 percent. Eleven million workers in this country owe their jobs to exports. On average, these jobs pay 13 to 17 percent more than non-trade jobs. Every billion dollars of exports supports, on average, 15,000 jobs. Clearly, expanding trade is critical to creating good, high-wage jobs.

We live in a world of opportunities. Dynamic economies in Asia and Latin America are growing at astounding rates. The United States has a mature economy, and we are nearly at zero population growth. We have four percent of the world's population. That means 96 percent of our potential consumers live outside our borders. To grow and prosper at home we must open the most lucrative markets in the rest of the world to U.S. exports -- in both our historic trading

partners like Canada, Europe and Japan, as well as the dynamic emerging countries in Asia and Latin America.

The Uruguay Round's Contribution

The bold vision for the multilateral trading system that Congress approved in the Uruguay Round Agreements is responding to these new realities. The broadest trade agreement in history, it plays to our strengths as the world's largest trading country, exporter and most productive economy. The United States has provided the world with the largest open market since World War II. The Uruguay Round and creation of the WTO gave us the opportunity to tear down the barriers that had impeded our reciprocal access. It opened foreign markets to U.S. exports in some of our most competitive industries. It contains a new set of trading rules suitable for the global economy as we approach the 21st century, including tough rules to settle disputes.

The WTO is clearly working.

This new system works to the benefit of U.S. workers in another, significant way. Under the old system, conflicts over trade issues brewed until they boiled over and had to be resolved by major "rounds" of negotiations. The WTO, however, is a forum for continuous trade negotiations on specific sectors and consideration of new issues. In the past, governments often delayed reducing their trade barriers by waiting for a round. Now the global trading nations can -- and must -- take a more methodical approach, facing issues head on. With resolute determination, we can systematically reduce barriers to U.S. exports and foster more open and fair trade.

A word about the size and scope of the WTO. The WTO is a stronger institution with more responsibilities than the GATT, monitoring a broader range of trade agreements, but this has not resulted in a significant increase in staff, nor has it changed the member-driven character of the Organization. The WTO Secretariat comprises a small number of highly trained professionals, led by Director General Renato Ruggiero, who took on the job just last May. As a result of the Uruguay Round, the WTO has undergone substantial scrutiny in terms of budget and personnel. Our conclusion: dollar for dollar, the United States gets substantial value from the WTO, especially considering the positive economic impact in terms of jobs and higher standards of living in the United States from the expansion in trade that will result from full implementation of the Agreements.

The results of the first year are impressive, even more so when one realizes that most of the tariff concessions are being implemented in stages, generally over five years. World goods trade is expected to grow by a very strong 8 percent in volume terms for full year 1995, reaching over $10 trillion (exports plus imports). This rate of real growth is almost 3 times faster than the estimated increase in world production in 1995. For the United States the gains are even more impressive in the first year of Uruguay Round implementation. U.S. exports rose by 14.4 percent on both volume and value bases in 1995, an increase that is almost 7 times greater than 1995's GDP growth. With well over $1.3 trillion in goods trade alone in 1995 (exports plus imports), the United States remains the world's largest trader.

The results are equally impressive in sectors that are particularly important to the U.S. economy and were the subject of intense negotiations in the Uruguay Round. For example, U.S. agricultural exports to WTO Members grew by 28 percent in the first year of the WTO's operation. Moreover, countries that heretofore had banned all imports of key U.S. products such as rice and apples were required to open their markets.

On the industrial side, the United States achieved substantial market opening by broad acceptance of the so-called "zero-zero initiatives," where the United States and other key countries agreed to reciprocal elimination of duties. Exports to WTO Members of products covered by these initiatives have grown nearly 30 percent in one year. Some examples of export growth are striking: U.S. exports of paper grew more than 40 percent; construction equipment by nearly 30 percent; and export growth in steel nearly doubled.

It is still too early to measure all of the benefits of the new Agreements. Some, like the intellectual property rights agreement, only entered into force fully on January 1, 1996. Others, as I have noted above, provide for phasing in of market access commitments and phasing out of barriers. But it is clear that the certainty and predictability of the multilateral system is working to our advantage. We are already seeing important trends. For example, many of our APEC partners are already accelerating their Uruguay Round commitments in order to spur the prospects for growth in the region.

In brief, the Agreements:

- cut tariffs worldwide on manufactured products, on average, by over one-third, the largest reduction in history;
- protect the intellectual property of U.S. entrepreneurs in industries such as pharmaceuticals, entertainment and software from piracy in world markets;
- ensure open foreign markets for U.S. exporters of services such as accounting, advertising, computer services, tourism, engineering and construction;
- greatly expand export opportunities for U.S. agricultural products by limiting the ability of foreign governments to restrict trade through tariffs, quotas, subsidies and a variety of other domestic policies and regulations;
- ensure that developing countries follow the same trade rules as developed countries and that there will be no "free-riders;"
- establish an effective set of rules for the prompt settlement of disputes, thus eliminating shortcomings in the previous (GATT) system that allowed countries to drag out the process and block judgments they did not like; and
- create an on-going forum for multilateral trade negotiations to assure that the rules of the system remain current and able to address pressing new issues such as the relationship between trade and the environment.

The Agreements do not, however:

- impair the effective enforcement of U.S. laws;
- impede U.S. action against foreign acts, policies or practices falling outside the scope of the WTO;
- limit the ability of the United States to set its own environmental and health standards and to pass its own laws; or
- erode the sovereignty of the United States to enact and enforce its laws.

The Uruguay Round was -- and is -- a good deal for U.S. workers and firms. All told, the Uruguay Round, when fully implemented, generally is estimated to add $100-$200 billion to U.S. GDP annually.

The WTO and the Debate on Sovereignty

Let me emphasize again that the WTO does not infringe on U.S. sovereignty.

The WTO retains many of the strengths and traditions of the GATT. It operates on the basis of consensus, and is a member-driven organization. It does not operate like the United Nations. Article IX of the WTO Agreement begins with the admonition that the WTO continue a nearly

fifty year practice of decision-making by consensus. And as the largest economy in the world, the United States has the major voice in making any decisions.

No substantive right or obligation of the United States can be altered or changed without our consent. The WTO does not affect the ability of the United States to pass its own laws, to enforce existing laws, or to set its own environmental or health standards. Only the U.S. government, along with state and local governments, can change federal, state or local laws or regulations.

We maintain the right to use our trade laws -- and this Administration is committed to using those laws. The Uruguay Round contains tougher dispute settlement rules which are already serving U.S. interests, but they are not our only tool to open foreign markets. We have used -- and will continue to use -- all of our trade laws to stand up for the interests of American workers and firms.

Of course, should we ever decide that the WTO is not working in our interest, which is very unlikely, in my opinion, to occur, we can simply leave the organization after a six month notice.

I would urge you to study carefully the views of a range of thoughtful commentators.

Professor John Jackson, author of the landmark treatise, *World Trade and The Law of the GATT*, testified to the Senate Finance Committee:

> It is doubtful that the WTO provides any additional institutional power to that effectively exercised by the GATT, and indeed, WTO clauses provide some additional checks and balances against misuse of authority. . . . A careful examination of the WTO Charter leads me to conclude that the WTO has no more real power than that which existed for the GATT under previous agreements...

Peter Suchman, former Deputy Assistant Secretary of Treasury for Tariff Affairs in the Nixon, Ford and Carter Administrations, observed:

> The World Trade Organization (WTO) represents a significant advance in the reform of the GATT. The Uruguay Round final provisions on dispute settlement and the WTO represent a major victory for U.S. negotiators, who had rejected the WTO concept as proposed early in the Round by Canada and the EC. The U.S. held out on the WTO as a means to ensure that its own trade laws, including Section 301, would not be unreasonably limited. And it worked! The WTO strikes a reasonable balance between the need to increase the effectiveness of the GATT panel system and the interests of the United States as the world's leading trading country....
>
> The United States, in pressing for freer trade and as the world's leading exporting nation, has historically been a plaintiff at the GATT more than a defendant. It is the United States that therefore has the greatest interest in an effective and expeditious GATT dispute settlement mechanism. We should be particularly pleased at the result of the Uruguay Round because the United States won inclusion of many of the provisions increasing the effectiveness of the dispute resolution process that it had suggested.

Joe Cobb, former Chief Economist for the Senate Republican Policy Committee and Minority Staff Director for the Joint Economic Committee of Congress, wrote for the Heritage Foundation:

> The creation of the World Trade Organization as a permanent rulemaking assembly for nations eager to expand exports is an historic achievement.... Without this uniform system of international trade law and the new rules in the Uruguay Round agreement, including the enforcement provisions, the U.S. would find it much harder to continue its economic progress into the 21st century.

Judge Robert Bork wrote:

> The sovereignty issue, in particular, is merely a scarecrow. Under our constitutional system, no treaty or international agreement can bind the United States if it does not wish to be bound...Congress should be reluctant to renege on an agreement except in serious cases, but that is a matter of international comity and not a loss of sovereignty.

Finally, Rhoda Karpatkin, President of Consumers Union, said when endorsing the Round:

> Through the mechanisms of competition and economic expansion [the Uruguay Round] will benefit American consumers. And, it will benefit consumers around the world. At the same time, it will permit the U.S. to maintain strong health, safety and environmental standards.

Review of Developments

In 1995, we were able to turn our efforts to implementation of the Agreements and bringing the WTO into reality. The details of these efforts are contained in our first report to Congress on WTO implementation mandated by the Uruguay Round Agreements Act.

My intention today is to focus on a number of selected issues that I know are on the minds of the members of this Committee, and to look at the year ahead, which will conclude with the WTO's first ministerial meeting in Singapore.

Dispute Settlement. While the dispute settlement mechanism in the WTO does not infringe on U.S. sovereignty, it is proving to be a very effective tool to open other nation's markets. In fact, the United States insisted on tough new dispute settlement rules. We bring -- and win -- a significant number of cases before dispute settlement panels. And we settle a lot of disputes by initiating the dispute settlement process and panel proceedings. Before the Uruguay Round, the global trading rules did less to benefit American workers. For example, under the old system, nations could decide which rules they wanted to follow.

One of the most important tools at our disposal is the WTO dispute settlement mechanism. We have in the past year had situations -- for example in dealing with the European Union on grains or Korea on "shelf life" standards -- where the specter of dispute settlement proceedings provided the needed incentive to resolve the problem. Currently, the United States is engaged in seven matters as a complaining party under WTO dispute settlement procedures, involving: Japanese taxes on distilled spirits; Japanese protection for rights in sound recordings; European Communities (EC) import restrictions on bananas; EC import restrictions on hormone-treated meat; Australian import restrictions on salmon; Korean regulations and testing/inspection requirements for agricultural imports; and Canadian barriers to the sale of U.S. magazines in Canada.

But, the dispute settlement panel process is not the only WTO forum used by the United States to assure that other countries' obligations are met. For example, under Articles XXIV:6 and XXVIII, the United States negotiated an agreement with the EC that compensates our U.S. companies for higher tariffs in Austria, Finland and Sweden as a result of their accession to the EC. Included in this agreement, which is worth more than $4 billion in duties to our companies over the next few years, is a significant reduction in the EC's semiconductor tariffs. Additionally, the United States is working in each of the WTO committees to ensure that obligations in each of the Agreements are fulfilled. For example, several countries implemented their commitments under the Agriculture Agreement more quickly than they would have if there had been no scrutiny by the WTO Members in the Committee on Agriculture, and others came under pressure to change their policies when the review process revealed possible WTO inconsistencies.

Transparency. When the Uruguay Round results were debated in the United States, one of the clear messages we sent to our trading partners was that further progress was needed in assuring

transparency in the operation of the WTO and its proceedings. It is clear that one of the most important steps we can take in ensuring fair trade in the multilateral trading system is by increasing transparency in its procedures and better understanding of the Organization and its rules.

U.S. efforts have been focused in the WTO initially on reforming practices with respect to the restriction and derestriction of WTO documents, including dispute settlement panel reports, and creating mechanisms for enhanced lines of communication between non-governmental organizations (NGOs) and the WTO. We have made progress towards this end and hope to achieve a consensus in Geneva to ensure public access to information regarding the WTO. We have made it clear that resolution of this issue is a high priority for the United States. Director General Ruggiero is seized with this issue in Geneva and has taken some important steps -- including providing access to the WTO on the Internet.

In addition, the President's Advisory Committee for Trade Policy and Negotiation (ACTPN) has just presented its second report on the WTO. The first report addressed the WTO's dispute settlement provisions in detail; the current report reviews the Uruguay Round Agreements in detail and provides policy recommendations on a wide variety of subjects. A third report is anticipated prior to the first meeting of the WTO Ministerial Conference in Singapore, this December. An important conclusion from the current report confirms what the Administration and many in the Congress have been saying: The WTO system provides substantial benefits to the United States and requires continued U.S. commitment and leadership.

Accessions. The number of applications for WTO Membership is at a record high, despite the much more rigorous requirements established by the WTO's "single undertaking." The list of applicants now numbers 29 and is growing, providing the United States substantial opportunities for market access in these new markets subject to the same set of rules we have undertaken. Equally important, many of these countries represent economies engaged in democratic reforms and transition to market-oriented regimes. Demanding a high standard of commitments from countries seeking to accede to the WTO is one area where the United States has demonstrated sustained leadership.

The Congress placed special emphasis on accessions in our debate on the Uruguay Round. I can report to you that the United States has, consistent with the provisions of the Uruguay Round Agreements Act, made it a priority to obtain commitments from new entrants at least similar to the terms accepted by all WTO Members. The results of the negotiations on Ecuador's accession reflect this reality, as do the positions we have taken for all accession applicants. To do otherwise would be detrimental to the system we worked so hard to establish.

The Year Ahead

Enforcement. A very high priority for the Clinton Administration in the year ahead is to remain resolute in ensuring that Agreements reached are implemented. We will continue to enforce our trade agreements and trade laws. For the multilateral system to remain credible, the agreements already in hand, as well as the current work before the WTO, must be fully implemented.

In addition to assuring implementation of the Uruguay Round Agreements and proceeding with all the accessions, the WTO provides an effective tool for enforcement of U.S. rights. To beef up our efforts to enforce our trade agreements and trade laws, in January 1996, we created a permanent Monitoring and Enforcement Unit at USTR devoted exclusively to monitoring implementation of U.S. trade laws and trade agreements, determining compliance by foreign governments with their trade agreement obligations, and pursuing actions necessary to enforce U.S. rights under those laws and agreements. This unit is supported by similar groups at the Departments of Agriculture and Commerce. We must stand up for American workers and companies -- as well as for the notion that the global trading system must be based on mutuality of obligations.

Basic Telecommunications Services. Important negotiations are under way in the services area that have enormous potential for the U.S. economy. Most of the new high-wage jobs created in the last few years have been in the services sector. Services exports are already equivalent to nearly 40 percent of the value of our merchandise exports and are growing dynamically. Americans are very competitive in responding to and creating new demands for services in the world marketplace.

The Uruguay Round established a General Agreement on Trade in Services (GATS), the first multilateral agreement dealing with services. The GATS covers all service sectors and represents a major breakthrough in setting agreed trade rules for these sectors. Further negotiations were called for in areas such as basic telecommunications services, in which talks are to be completed by April 30 of this year.

The United States maintains one of the world's most open and competitive telecommunications markets. Our objective in the negotiations is, quite simply, to obtain similar levels of openness to foreign investment and competition in the markets of other major trading partners, most of which are dominated by single providers, private or public. Greater openness to competition in telecommunications services will allow new investment to fill unmet demand in many markets around the world. This has enormous potential benefits for manufacturers of telecommunications, computer and aerospace equipment and telecommunications suppliers.

I wish that I could report to you that all that remains for success is to obtain the signatures of all WTO Members. Regrettably, we do not yet have contributions from a critical mass of countries to declare success, but we still have some days ahead of us. Clearly, a strong agreement in this area is good for the sector, and the WTO. It is also, frankly, a test for those who seek to bring new issues to the WTO, such as investment and competition policy. Both of these issues are important in the current negotiations.

The basic telecommunications services negotiations cannot be limited to the traditional issues of market access and access for investment. The reason is that in most foreign countries, the telecommunications services provider is a monopoly, usually a state monopoly. For this reason, a successful agreement must also include commitments to adopt Procompetitive Regulatory Principles -- that is, commitments that assure new entrants in foreign markets have a chance to compete with entrenched monopolies. For example, we need a rule that provides that when a foreign telecommunications company seeks to interconnect through a former monopoly, it may do so on reasonable and non-discriminatory terms. We should also require transparency in foreign telecommunications services licensing. We have laid down an ambitious paper on this subject and are discussing it with our trading partners.

Singapore Ministerial Meeting. The WTO will embark on a series of regular ministerial sessions to be held, according to the WTO Agreement, at least once every two years with the first meeting in Singapore, December 9-13, 1996. The purpose of such meetings is to assure regular, political level review by ministers of the operation of the WTO. This is a major change from the GATT, where ministerial meetings were traditionally only convened to launch or conclude negotiations. The WTO, unlike the GATT, was intended to provide an on-going forum for negotiation and liberalization. Thus, the WTO ministerials will take on a different character. As the first of these sessions, the Singapore meeting cannot avoid setting certain precedents and the United States is therefore taking great care to ensure that the first conference is realistic in its aspirations. The WTO General Council is responsible for developing the agenda for the meeting. The agenda will involve at least five major issue areas:

- Implementation of the Agreements;
- The WTO's "built in" agenda, including in areas where further negotiations were called for prior to the 1996 ministerial;
- The Committee on Trade and Environment's report and possible recommendations, as mandated by Ministers at Marrakesh;

- Possible trade liberalizing initiatives, including in the area of market access; and

- Issues to add to the WTO's agenda.

The first three of these issues -- implementation, the built in agenda and the work of the Committee on Trade and Environment -- are already a major focus of work in Geneva and, undoubtedly, will receive attention by Ministers at the Singapore meeting. The Committee on Trade and Environment will provide its first report to Ministers, including any recommendations for action regarding the relationship of trade rules to environmental concerns identified in the Committee's work program. It is clear that many WTO Members share the U.S. view that the work of this Committee will be an important element of the Ministers' agenda at Singapore. We will also have to anticipate work to be undertaken between 1996 and 1998 in important areas. For example, Ministers will want to focus on needed preparations for further actions required in the individual Agreements. In many cases, the Agreements already call for further negotiation or review after 1996 -- for example, with respect to agriculture, industrial subsidies and services.

Market Access and the Information Technology Agreement. Although not specifically provided for in the Uruguay Round Agreements, Members have already signaled that additional market access opportunities should be the focus of attention at Singapore. A number of suggestions have been made, including accelerating tariff reductions and expanding market access in particular sectors. The United States, within the confines of existing tariff cutting authority, is ready to pursue further market access agreements. The United States continues to have substantial tariff cutting authority to pursue further the sectoral and harmonization initiatives that were priorities in the Uruguay Round. U.S.-EC agreement in late 1995 to pursue an Information Technology Agreement (ITA) should galvanize efforts multilaterally in 1996 to reduce further barriers to market access in this important sector. It is hoped that agreement can be secured by Singapore so that the ITA can be fully implemented by 2000.

I understand that the Committee will hear testimony from representatives of the ITA Coalition. We are working closely with industry on this endeavor and appreciate the activist approach that they have taken with us to pursue the ITA.

Adding to the WTO's Agenda. Finally, Members have argued that the WTO must continue to look forward and to continually add new items to its agenda once the necessary consensus is developed by WTO Members, just as we did for trade and the environment as the Uruguay Round concluded. Among the most prominent of these issues are: the relationship of trade to internationally-recognized labor standards, anti-corruption efforts in international trade, particularly in the area of government procurement, and foreign direct investment and competition policy. Not surprisingly, the United States has an interest in all these issues.

Trade and Labor Standards. As the Committee well knows, successive Administrations have, since the launch of the Uruguay Round in 1986, attempted to build consensus for GATT and now WTO consideration of the relationship between trade and labor standards. This was among the issues that was identified at the Marrakesh ministerial meeting in April 1994 and included in the URAA where the President was directed to seek the establishment of a WTO working party to examine the relationship between trade and labor standards. To date, however, developing a needed consensus for multilateral work within the WTO has not been possible.

Nonetheless, the Administration is continuing to pursue the establishment of a working party as one of the issues for Singapore. On-going work in the Organization for Economic Cooperation and Development (OECD) may help to develop this consensus. Current analysis within the OECD is focusing on core labor standards that are both human rights and preconditions for the achievement of better working standards. These are: freedom of association; collective bargaining; elimination of exploitative forms of child labor; prohibition of forced labor; and non-discrimination in employment. Working with other like-minded countries and the International Labor Organization (ILO), we hope to use the OECD's efforts and the growing recognition

around the world that there is a relationship between trade and labor issues to begin long-awaited work in the WTO on this issue.

Bribery and Corruption. The prevalence of bribery and corruption in international transactions undermines confidence in the global trading system and threatens to negate our gains on market access which we have already negotiated and agreed upon. The WTO is already making an important contribution to combatting these practices in the trade area. Several WTO Agreements already deal with some of the problems we have with bribery and corruption. The Preshipment Inspection and Customs Valuation Agreements apply to all WTO Members and protect against corruption in the use of customs procedures. Additionally, the TRIPs Agreement curbs the theft of intellectual property worldwide. But the WTO can and should do more to deal with this situation.

We will continue to seek to extend the WTO Government Procurement Agreement, which, because of its rigorous disciplines, excludes key markets in Asia, the Americas, Eastern and Central Europe and Africa. Estimates of the value of procurement markets in these countries approach $1 trillion or more. At the same time, the United States has proposed that all WTO Members begin negotiations following the Singapore ministerial on an interim WTO procurement agreement focusing on transparency, openness and due process. WTO Director General Ruggiero has pledged himself to work with me in furthering this objective.

Investment. Work is under way in the OECD to establish a Multilateral Agreement on Investment. Some have argued that the WTO is really the better place to have such negotiations. We have taken the view that no subject should be declared "off limits" to the WTO. But it is not clear to us that the WTO is ready to embark on substantial new negotiations on investment in the short term. We look for continued progress in OECD negotiations toward an investment agreement that will set high standards for investment protection.

Competition Policy. Others have argued that work should begin in the WTO to examine the relationship between trade and competition policy. After the negotiations on basic telecommunications are completed we should be in a position to gauge the extent to which the WTO is ready to embark on this issue.

Conclusion

I have not touched on all the issues before the WTO, given the breadth of its coverage. All of the issues before the WTO are important to the United States. That has to be the case. The United States has the largest economy in the world, is the largest trading nation and has the most open large economy in the world. Our efforts must always be to press foreign nations to open their markets, not shut down our own. This is critical to our efforts to create a better life for all Americans.

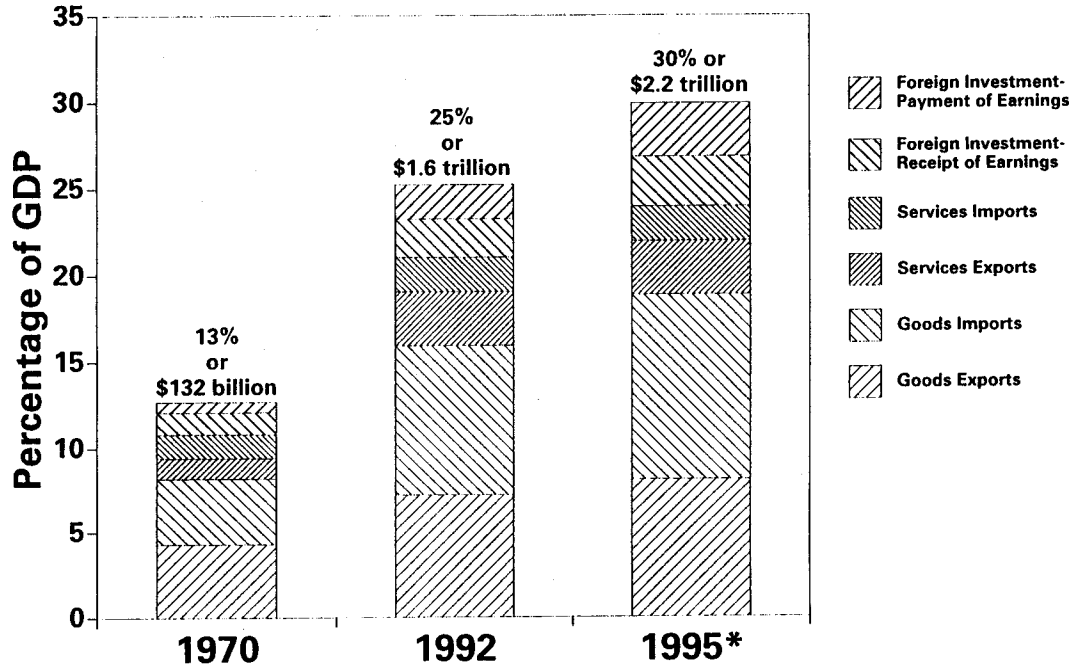
The President is committed to doing everything he can to open foreign markets so American workers, farmers and businesses can sell their products abroad. He knows that is how we must create high-wage, high-skill jobs in this country and raise our standards of living. We cannot afford to build walls of fear around our country.

The President has set the nation on a course that will forge prosperity into the next century. The President, with the bipartisan support of Congress, is doing his part by standing up for American workers, opening foreign markets and pressing to ensure fair trade rules. But we must all work together to get there. All of us -- whether we are in government, business, are a student or a farmer -- must do our part to forge new opportunities for the American community. As Americans we must join together to create the new American Century -- an era of limitless possibilities. Together, we can build a better future.

Thank you very much.

Growing Importance of Trade to the U.S. Economy

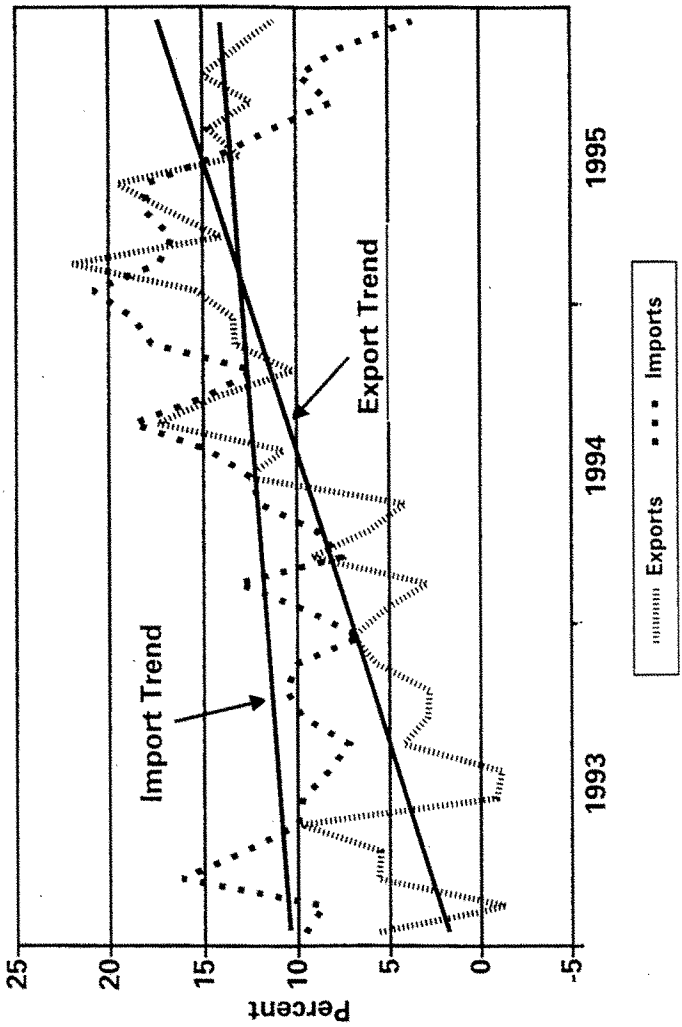
Total exports plus total imports as a percentage of the value of U.S. GDP



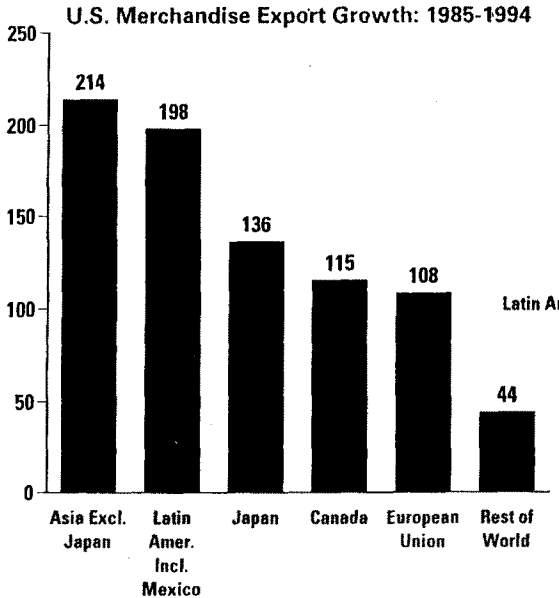
*annualized from 1st (3) quarters

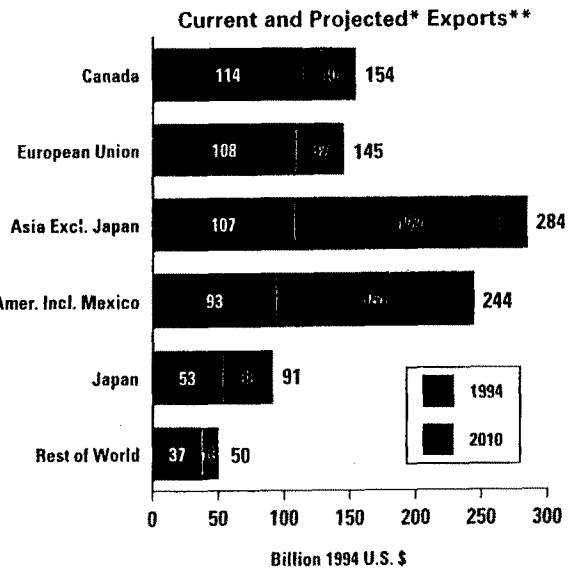
Exports Booming

Trends in the Growth Rates of U.S. Goods Exports & Imports to the World
January 1993 – November 1995
(Percentage change from same month of previous year)



Future Export Growth





*Based on U.S. Government estimates of growth in foreign export markets and the assumption that the U.S. share of those markets remains constant.

**Merchandise exports were $512 billion in 1994. They are projected to rise to $968 billion in 2010 in constant 1994 dollars and $1,183 billion in current dollars, based on historic trends in export price inflation.

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May 5, 1994

The Honorable Daniel P. Moynihan
Chairman, Senate Finance Committee
SR-464 Russell Senate Office Building
Washington, D.C. 20510-3201

The Honorable Dan Rostenkowski
Chairman, House Ways and Means
2111 Rayburn House Office Building
Washington, D.C. 20515-1305

Dear Chairman Moynihan and Chairman Rostenkowski:

As President of the American Bar Association ("ABA"), I would like to call to your attention the ABA's view that U.S. sovereignty is unharmed by certain Uruguay Round agreements.

Specifically, the ABA strongly supports two particular legal reforms to the GATT trading system that are embodied in the so-called "Uruguay Round" agreements. These are (1) the changes to GATT dispute settlement procedures, and (2) the development of a World Trade Organization ("WTO"). Having studied these matters as lawyers familiar with both U.S. and international law, the ABA firmly believes that the United States will benefit significantly from these reforms, with no adverse impact on U.S. legal powers or sovereignty.

In particular, the Uruguay Round dispute settlement provisions leave U.S. domestic legal powers totally intact, just as they were under the old GATT rules. Likewise, the WTO simply provides an updated procedural framework for dealing with GATT trade issues. It gives the U.S. more, not less procedural protections than the old GATT. Finally, none of these changes permits GATT rules to override U.S. domestic law, so U.S. sovereignty remains intact.

The ABA's resolution in support of these aspects of the Uruguay Round agreements and the supporting report that analyzes them are attached for your

reference. The key points related to these two reforms are summarized below.

1. Uruguay Round Dispute Settlement Reforms Are Positive For the United States

The Uruguay Round changes to existing GATT dispute settlement procedures improve the status quo to the benefit of the United States. Key accomplishments include:

- Streamlining dispute settlement by eliminating the confusing and sometimes ineffective array of different dispute settlement proceedings that existed under the old GATT codes;
- Beginning the process of opening dispute settlement proceedings by amending certain of the old GATT rules that permitted all of the proceedings to go on in secret;
- Permitting an appeal from a dispute settlement panel ruling, a step not available under the current GATT rules; and
- Meeting one of the United States' main concerns about the current GATT dispute settlement rules by ensuring that other countries enter dispute settlement promptly and in good faith, and by ending the old practice of blocking the results of these proceedings.

It bears emphasis that the Uruguay Round changes to GATT dispute settlement do not change the United States' domestic legal authority to decide independently of any other nation or body how to implement a GATT panel ruling. Indeed, although such a circumstance hopefully will not arise, Uruguay Round

reforms also do not affect U.S. domestic powers to decide not to implement a particular GATT ruling. Accordingly, Congress' powers over international trade matters affecting U.S. interests are not diminished in any respect by the Uruguay Round changes.

2. Development of the WTO Is Likewise Extremely Helpful to U.S. Interests

The WTO is a positive procedural development for both the United States and the rest of the current GATT system. For the first time, the WTO achieves the following U.S. aims:

- Ensures that all member countries (not just the U.S. and a few others) will be adhering to all of the agreed GATT rules in areas ranging from intellectual property to subsidies; and

- Sets up a single, coherent procedural framework for dealing with a trade issue, whether related to goods or services.

The WTO charter does not create any new substantive rules that countries must follow. (The substantive rules are all contained in independently negotiated agreements on various subjects that are annexed to the WTO charter.) The WTO also does not diminish the U.S. procedural powers and rights enjoyed under the ad hoc procedural framework that has developed over time with the current GATT. In fact, the WTO offers the United States more procedural protections than the current GATT does. For example, the WTO incorporates larger majority voting rules and the requirement of unanimous votes on more critical issues. These changes ensure that important U.S. interests cannot be overridden through procedural ploys within the WTO.

In short, the WTO and the new Uruguay Round rules on dispute settlement will permit the U.S. to work more effectively and efficiently within the

international trading system without creating any threat to U.S. domestic legal prerogatives. These changes undoubtedly will help the U.S. to achieve its goals of truly open international markets by encouraging the fair application of agreed legal rules around the globe.

Please do not hesitate to call Claire Reade (202-872-3719) or Mark Sandstrom (202-331-8800), Co-chairs of the ABA International Law Section's Committee on International Trade, if you have any questions.

Sincerely,

R. William Ide III

cc: Ambassador Mickey Kantor
Members of the Senate
Members of the House of Representatives

EMPOWER AMERICA

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May 13, 1994

The Honorable Jim Sensenbrenner, Jr.
U.S. House of Representatives
2332 Rayburn House Office Building
Washington, D.C. 20515

Dear Representative Sensenbrenner:

Six months ago, in a proud moment for our Party, Republicans rose above partisan and protectionist politics and provided the margin of victory for the historic free trade agreement with Mexico. Soon, you will be called upon to cast an even more crucial vote. While NAFTA was a victory for free and open trade in our hemisphere, GATT will be a victory for free and open trade throughout the world.

The new GATT agreement represents the largest tariff cut in world history – and tariff cuts are, in reality, the equivalent of a pro-growth tax cut for American workers, consumers, and businesses. Since the original GATT agreement was enacted in 1948, U.S. exports have increased from $13.3 million to nearly $450 billion as of 1992. Today, one in six American manufacturing jobs are tied to exports. The new GATT agreement will accelerate this trend, contributing $130 billion in additional U.S. economic growth by the end of the 1990s, according to one study.

However, some of our colleagues have raised concerns over GATT which I would like to address.

First, the new World Trade Organization is not a threat to U.S. sovereignty. As Joe Cobb of the Heritage Foundation clearly points out in his excellent review of the GATT agreement, the World Trade Organization will have absolutely no legislative, executive, or judicial authority. Nothing it proposes can change U.S. laws. Only Congress has that power.

The new GATT dispute settlement procedures will make it more difficult for countries to impose trade barriers on American goods and services. Its arbitration process will force countries to the negotiating table, discouraging potentially devastating trade wars. It will also extend international protection to intellectual property,

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Executive Director
Charles M. Kupperman

including items where America dominates such as computer software, computer chip design, patents, and copyrights, and to trade in services – America's major export sector. In addition, the new GATT agreement will subject agriculture to international trade rules for the first time which will dramatically expand markets for efficient U.S. agricultural producers. This is a large step forward.

Ultimately, Republicans and conservatives who use the sovereignty issue to oppose GATT will be accused of failing to pass the largest international tax cut in history.

Second, while I am adamantly opposed to a tax increase to finance a cut in tariffs, Republicans should not allow the $14 billion financing issue to derail GATT. Nearly everyone is in agreement about GATT's dynamic impact on world trade and the U.S. economy, but we must not revert to static analysis when judging its budget impact. Tariff cuts will expand trade and increase government revenue. Republicans must argue the dynamic effects of expanded trade and seek a budget waiver or spending cuts to offset the static revenue loss erroneously predicted by the Clinton Administration.

As you study both sides, I am sure you will agree with me the new GATT agreement is overwhelmingly good for the United States and the global economy. Now is not the time for Republicans or Americans to become afraid of an expanded system of fair trading rules, just at the turning point of history when every other nation seeks to embrace entrepreneurship, competition, and freer markets as we did in electing Ronald Reagan and George Bush in the 1980s.

Very sincerely yours,

Jack Kemp

MICHAEL E. CARPENTER
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July 27, 1994

via fax and U.S. mail

Honorable Michael Kantor
U.S. Trade Representative
209A Winder Building
600 17th Street, N.W.
Washington, D.C. 20506

Dear Ambassador Kantor:

As the Attorneys General of our respective states and as the leadership of the National Association of Attorneys General (NAAG) workgroup on trade issues, we write to express our satisfaction with the proposed amendments to the GATT implementing legislation and statement of administrative action that our respective staffs have developed over the last ten days. The NAAG workgroup on trade issues has convened nearly daily since our July 15 meeting in Washington with your General Counsel, Ira Shapiro, to review the provisions which have been negotiated by our staffs.

The document which has been developed not only meets essential needs of the states but has also had the important byproduct of fostering the type of productive communication and interaction between your office and the states that gives us confidence that not only the letter, but the spirit, of this agreement will be adhered to.

The specific benefits of our agreement for states importantly include:

- the right of states to specific notice, information and participation in key proceedings affecting their state laws;

- substantial protections for the states that level the playing field between state and federal government where the federal government seeks to overturn state law in U.S. District Court, including a bar on retroactive relief; and

- the elimination of the private right of action so as to bar either the private sector or foreign governments from preempting state or local laws.

Honorable Michael Kantor
July 27, 1994

We would be remiss if we did not acknowledge the fine work that U.S. Senator Kent Conrad has done in championing these issues. His contribution to the process has been immeasurable.

The major points of our agreement should not belie the importance of the dozens of specific provisions which give clear and effective meaning to these federal obligations. In summary, in a separate communication, we are strongly recommending to our colleagues, the Attorneys General of the other states who joined us in initiating this dialogue, that this comprehensive agreement be supported as one that effectively preserves for the states a meaningful role and significant opportunity to defend and protect state law.

Sincerely,

Michael E. Carpenter
Attorney General of Maine
Chair, NAAG Trade Workgroup

Charles W. Burson
Attorney General of Tennessee
NAAG President

Heidi Heitkamp
Attorney General of North Dakota
Vice Chair, NAAG Trade Workgroup

Joe Cobb
John M. Olin Fellow in Economics

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MEMORANDUM

April 13, 1994

TO: SEAN MULVANEY
Office of Congressman Jim Kolbe

The Issue of U.S. Sovereignty Under the New GATT Agreement

Next week The Heritage Foundation will publish "A Guide to the New GATT Agreement," a *Backgrounder* that will examine every section of the Uruguay Round agreement. We have looked closely at the question raised by some conservatives concerning the issue of United States sovereignty and whether the new World Trade Organization (WTO) will infringe on America's rights and independence. The sections of our *Backgrounder* that focus on this question are excerpted below. You may find this discussion useful in replying to constituents who are worried about any loss of U.S. sovereignty.

Why the WTO Poses No Threat to U.S. Sovereignty

Whenever the United States has joined an international organization, such as the United Nations or NATO, the question arises whether U.S. sovereignty is compromised. Sovereignty is a nation's shield against foreign interference in its domestic matters. Opponents of the North American Free Trade Agreement raised the concern of sovereignty,[1] and critics of the Uruguay Round voice the same concern.

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[1] Populists such as H. Ross Perot and conservatives such as Patrick J. Buchanan argued that the North American Free Trade Agreement contained provisions to supercede the U.S. courts and the Constitution.

This concern is unfounded. The WTO Agreement specifically provides that future amendments to the substantive rights and obligations of the members may only be adopted by a two-thirds vote. More to the point, amendments can only become binding on those WTO members that accept them. The United States thus could not be bound by any substantive amendments to international trade rules under the WTO that Congress did not accept.[2]

The critics' main concern, however, is the extent to which U.S. authority to impose unilateral trade sanctions, and to protect domestic political interests, will be limited.[3] While imposing a tariff or quota is clearly an exercise of sovereign power, the question has to be whether sovereignty is impaired by agreeing to arbitration before doing so. Prior to the Uruguay Round agreements, many trade-related problems were not covered by GATT, and if a trade dispute could not be resolved bilaterally, the United States had no course other than to act alone. As a member of the World Trade Organization, the United States would be able to take complaints to a dispute settlement panel. All countries would abide by those judgments.

Representative Dick Armey (R-TX), chairman of the House Republican Conference, cogently answered critics of the North American Free Trade Agreement who made the same sovereignty argument:

> Any treaty or agreement restricts a participating government's policy choices to some extent. When the U.S. government decides to conduct its relations — economic, security or otherwise — with a country in a certain manner, it precludes, for the moment, following other courses of action. This is not a limit on sovereignty. It is instead the selection of one policy that necessarily excludes selection of the alternatives.[4]

The critics' desire to retain the right to act unilaterally in trade disputes in any case begs the question of what is the national interest. To surrender the power to act unilaterally and defend the national interest of *all* Americans would be to

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[2] Office of the U.S. Trade Representative, *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (Version of 15 December 1993)*, II, pp. 6-8.

[3] This claim is made by the United States Business and Industrial Council, an organization that asserts "trade liberalization in the GATT [has] weakened, rather than strengthened, our international competitive position." (letter to Congressional Trade Policy Staffers, March 14, 1994).

[4] House Republican Conference, "NAFTA: Restoring Sovereignty to Individuals," *Issue Brief*, October 15, 1993, p. 3.

submit to foreign influence. But trade sanctions invariably benefit *some* Americans, and adversely affect the economic interests of others. The sovereignty argument is vitiated because the usual situation finds a special interest urging the U.S. government to put a narrow tax on the products other Americans want to import. The sovereignty argument cannot be invoked to justify protectionist trade sanctions that benefit a narrow interest, and injure others, any more than sovereignty can justify pork barrel legislation for special interests domestically.

Conservatives, however, also understand the sovereignty argument in a different sense, as embodying the principles of "limited government" and "economic civil rights." In this sense, the World Trade Organization will expand the sovereignty of American citizens by reducing the power of interest groups to manipulate trade policy. Representative Armey affirmed this principle during the NAFTA debate:

> [This agreement] does take the power to block free exchanges between individuals — in the form of tariffs and non-tariff barriers — out of the hands of the governments .... In this way it restores the sovereign freedom of individuals to dispose of their property as they see fit — e.g., to sell or buy from citizens of other countries without government interference. Restoring individual sovereignty is the most important benefit of [the free trade agreement].[5]

Conservatives staunchly defend the right to freedom of contract and private property, allowing entrepreneurs, workers, and consumers to seek economic opportunities with the minimum need to seek government permission. The GATT codes, and the restrictions the World Trade Organization will hold over 119 member governments, are steps forward for individual rights and the free market, just as the U.S. Constitution is a charter for *limiting* the sovereign power of the government, in favor of individual rights and private property.

Conclusion

After the Second World War, there was a consensus that many of the crises of the interwar period were related to trade protection. Economic nationalism in the 1930s clearly had contributed to hostilities, and the political control of

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[5] *Ibid.*, p. 9.

resources was an explicit part of the Axis Powers' war aims. The fortunate demise of the proposed International Trade Organization, which in the intellectual climate of the times would probably, have resembled an international economic planning agency, and the almost coincidental founding of GATT led to a "rules based" international trading system governed by voluntary compliance, out of self-interest, by an ever-increasing number of developing countries.

The new GATT agreement is far-reaching and may well represent the international equivalent of the kind of free and fair trade provided domestically to the United States by the Interstate Commerce clause of the U.S. Constitution. As this country was emerging from the British mercantilist empire, there were clear dangers that local interests in each state would erect trade barriers. The Constitution avoided this danger and there can be no doubt that the rise of the United States to dominate the world economy in the 20th century is directly related to the creation of the vast free trade zone.

As important to the United States' economic progress as free trade was the uniform rule of law that made inter-regional trade possible. Similarly, GATT's most important benefit has been to discourage trade practices by its member governments that discriminate against foreign producers, and to require equality of treatment. Central to GATT's system of fair trade are the principles of most favored nation status, which forbids a government to favor some foreigner producers over others, and national treatment, which forbides a government to favor its own nationals over foreigners. The United States could never have realized its potential for world economic leadership if the individual States had been allowed to impose the barriers that already were beginning to appear in 1787.

The creation of the World Trade Organization as a permanent rule-making assembly for nations eager to expand exports is an historic achievement. It will give consumers in all nations better access to the most technologically and scientifically advanced goods and services, and allow them to benefit from the free movement of capital investment. Without this uniform system of international trade law and the new rules in the Uruguay Round agreements, including the enforcement provisions, the U.S. would find it much harder to continue its economic progress into the 21st century.

The concern that United States sovereignty would be compromised by participation in the World Trade Organization is a dangerously confused argument, which is exploited by some opponents of open trade and will be voiced

in the upcoming Congressional debate over the new agreement. It is important that lawmakers remember that the sovereignty argument cannot possibly be valid when it is used to justify the special privileges of a few against the economic interests of the whole population. The ultimate sovereignty that must be protected is the sovereignty of ordinary Americans to be as free as possible to make the economic and other decisions that affect their jobs and families.

The GATT codes and the essentially negative, disciplining, and restrictive authority the World Trade Organization will hold over 119 member governments are steps forward for individual rights and the free market, just as the U.S. Constitution is a charter for *limiting* the sovereign power of the government, in favor of individual rights and private property. As Representative Dick Armey (R-TX) has argued, to "take the power to block free exchanges between individuals — in the form of tariffs and non-tariff barriers — out of the hands of the governments ... restores the sovereign freedom of individuals to dispose of their property as they see fit — e.g., to sell or buy from citizens of other countries without government interference. Restoring individual sovereignty is the most important benefit...."[6]

The World Trade Organization promises to bring to the world economy the essential system of the rule of law, without the constraining and distorting forces of a sovereign national political process. When evaluating the GATT implementing legislation, lawmakers must not forget this essential separation in a free market between the the political process, so heavily influenced by narrow economic interests, and the private economic interests of every constituent. The rule of law is essential to economic growth and progress, but politics is often destabilizing and detrimental to progress. The GATT agreement and the WTO it creates, seems well structured to keep economic freedom dominant over the interest-group political pressures that compete to influence governments.

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[6] *Ibid.*

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Heritage Foundation, with more than 200,000 contributors, is the nation's most broadly based, conservative policy research organization

ROBERT H. BORK

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WASHINGTON, D. C. 20036

May 26, 1994

Ambassador Michael Kantor
Office of the U.S. Trade Representative
600 17th Street, N.W.
Washington, D.C. 20506

Dear Mr. Ambassador:

I understand that opposition to the Uruguay Round agreements has focused on the creation of the World Trade Organization (WTO). The claim, which was also made with respect to NAFTA, is that the WTO is a threat to the sovereignty of the United States.

It is difficult to resist the conclusion that some of those who make this claim are actually opposed to the lowering of tariff and non-tariff barriers in international trade. The protectionist impulse is strong but it is contrary to the best interests of American business, workers, and consumers.

The sovereignty issue, in particular, is merely a scarecrow. Under our constitutional system, no treaty or international agreement can bind the United States if it does not wish to be bound. Congress may at any time override such an agreement or any provision of it by statute. (The President would, or course, participate as the Constitution provides in the enactment of such a statute.) Congress should be reluctant to renege on an agreement except in serious cases, but that is a matter of international comity and not a loss of sovereignty.

The same observations apply to the Dispute Settlement Understanding (DSU). A mechanism for settling trade disputes is essential if the aims of the Uruguay Round agreements are to be achieved. It is extremely unlikely that any country will agree with all recommendations as to the resolution of the disputes in which it is involved. There is no dispute resolution process anywhere that can achieve that result. Once again, however, recommendations made under the DSU do not bind Congress and the Executive Branch unless those departments of government choose to be bound.

Ambassador Michael Kantor
May 26, 1994

Protection of U.S. sovereignty, however, does not depend solely on the undoubted ability of our political branches to nullify or modify agreements or recommendations. The WTO itself contains numerous safeguards concerning procedures which protect not only the sovereignty but the interests of all nations, including the United States. It appears that these safeguards are either the same as or stronger than those already existing in the GATT, under which we have operated successfully for decades.

In sum, it is impossible to see a threat to this nation's sovereignty posed by either the WTO or the DSU. Any agreement liberalizing international trade would necessarily contain mechanisms similar to those in the Uruguay Round agreements. The claim that such mechanisms are a danger to U.S. sovereignty is not merely wrong but would, if accepted, doom all prospects for freer trade achieved by multi-national agreement.

Yours truly,

Robert H. Bork

RHB:lh

STATE OF WASHINGTON
OFFICE OF THE GOVERNOR
2001 Sixth Avenue, Suite 2610 • Seattle, Washington 98121 • (206) 464-7143 • FAX (206) 744-7222

August 4, 1994

The Honorable William J. Clinton
President of the United States
1600 Pennsylvania Avenue NW
Washington DC 20500

Dear President Clinton:

At its recent meeting in Boston, the National Governors' Association unanimously adopted a policy statement in support of the bill to implement the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), and we, the undersigned Governors, want to write separately to emphasize the importance of the timely enactment of GATT to our respective states' economies.

First, we want to commend you, and former Presidents Reagan and Bush, for your leadership in helping reach a successful conclusion to the long, arduous negotiations last December. The entire world economy, and especially that of the United States, will benefit greatly from the greater trade and economic opportunities created by the trade liberalization measures in the Agreement.

We understand the Administration has been working closely with the relevant Congressional committees recently and is nearly ready to submit an implementing bill. The budget implications of the bill, in terms of lost tariff revenue, are not insignificant and need to be addressed under the current budget rules. But we urge you not to lose sight of the tremendous economic activity that greater trade liberalization will generate. We have reviewed reliable economic projections, used by your Administration, that estimate this Agreement should add between $100 to $200 billion to U.S. GDP annually when fully implemented. Also, the net U.S. employment gain which will be created by the Agreement is estimated to be 1.4 million jobs by the tenth year after enactment. This economic growth will undoubtedly generate additional revenues both at the federal and state level.

Moreover, as Governors, each of us has a vital obligation to create well-paying jobs for the citizens of our state. Indeed, our commitment to our state's economic prosperity is the primary reason each of us was elected to office. International trade has an increasingly large impact on our state's economic vitality, as witnessed by the rapid growth in exports over the past several years. We note that U.S. exports of goods and services reached $660 billion in 1993, with exports to the developing world growing the most rapidly -- 50 percent since 1990. Exports

The Honorable William J. Clinton
August 4, 1994

have been an important component of economic growth since the 1990-91 recession; in fact, real GDP would have been reduced by about 27 percent and would have lengthened the recession without export growth. The Uruguay Round of the GATT will complement the active efforts of Governors to promote our respective state's exports and spur investment flows internationally.

The states continue to have concerns about their role in the WTO/GATT dispute settlement process which have been addressed in the policy recently adopted at the NGA meeting in Boston. The states will need to be involved more closely than ever in the implementation of this Agreement. The World Trade Organization (WTO) will likely become a more frequent mediator of trade disputes since this Agreement is plowing new ground in areas such as agriculture, intellectual property, subsidies, and services. Indeed, the more streamlined dispute settlement procedures in this Agreement have been a goal of U.S. trade negotiators for some time. On balance, we believe the new dispute settlement procedures will work to the benefit of the United States, since we have established a good winning record with GATT cases.

Sincerely yours,

Mike Lowry
Governor of Washington State

Jim Edgar
Governor of Illinois
NGA Co-Lead Governor
on International Trade

Ann W. Richards
Governor of Texas
NGA Co-Lead Governor
on International Trade

cc: See attached list of Governors signing the letter.

Governor's GATT Letter Signatures
August 4, 1994

Governor Walter J. Hickel
State of Alaska

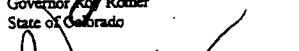
Governor Terry E. Branstad
State of Iowa

Governor Jim Guy Tucker
State of Arkansas

Governor John Waihee
State of Hawaii

Governor Roy Romer
State of Colorado

Governor Joan Finney
State of Kansas



Governor Lowell P. Weicker Jr.
State of Connecticut

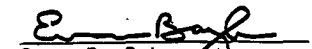
Governor Edwin W. Edwards
State of Louisiana

Governor Tom Carper
State of Delaware

Governor William Donald Schaefer
State of Maryland

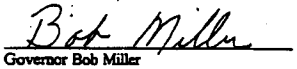
Governor Cecil D. Andrus
State of Idaho

Governor William F. Weld
Commonwealth of Massachusetts



Governor Evan Bayh
State of Indiana

Governor John Engler
State of Michigan



Governor Bob Miller
State of Nevada

Governor Bruce Sundlun
State of Rhode Island

Governor Christine T. Whitman
State of New Jersey

Governor Walter D. Miller
State of South Dakota

Governor Bruce King
State of New Mexico

Governor Ned Ray McWherter
State of Tennessee

Governor James B. Hunt Jr.
State of North Carolina

Governor Howard Dean, M.D.
State of Vermont

Governor George V. Voinovich
State of Ohio

Governor George Allen
Commonwealth of Virginia

Governor David Walters
State of Oklahoma

Governor Gaston Caperton
State of West Virginia

Governor Barbara Roberts
State of Oregon

Governor Mike Sullivan
State of Wyoming

Governor Pedro Rosselló
State of Puerto Rico

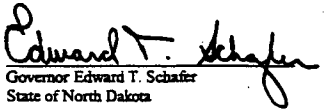
Governor Pete Wilson
State of California

Governor Mel Carnahan
State of Missouri

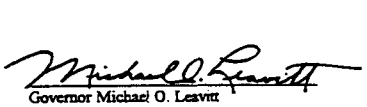
Governor Lawton Chiles
State of Florida

Governor Jim Folsom
State of Alabama

Governor Brereton C. Jones
Commonwealth of Kentucky



Governor Edward T. Schafer
State of North Dakota



Governor Michael O. Leavitt
State of Utah

Governor Carroll A. Campbell, Jr.
State of South Carolina

Chairman CRANE. Thank you very much, Mr. Ambassador.

Before we commence questioning, I would like to yield to Mr. Rangel, our Ranking Minority Member.

Mr. RANGEL. Thank you.

I would hope that I could put my statement in the record, Mr. Chairman.

Chairman CRANE. Without objection, so ordered.

Mr. RANGEL. I would just welcome one of the most exciting personalities we have in government today.

You are honored to lead America forward during a revolutionary change in the way our government trades and with whom we trade. This means it is going to change how Americans look at foreigners and understand them as we try to get a better understanding of what our great country represents.

I cannot think of anything we are lucky enough to be around as during this change, but these changes cause a lot of pain to people who lose their jobs, who are not qualified to catch up with the times, and no matter how much we want to find equity on both sides, you know that most of these developing countries don't have the high standards for workers and their rights as we do.

So, as we move forward, having to try to balance it, I look forward to working with you, and I pray we can continue to do this in a bipartisan way, notwithstanding what Presidential candidates have to do, notwithstanding how mean Mr. Castro is. I do hope we rely on experts such as yourself, so we can be driven in these policies by what is good for our great country and what is good for the free world.

I just want to thank you for the contributions that you have made over the years and let you know how much Republicans and Democrats appreciate your effort.

[The opening statement follows:]

OPENING STATEMENT OF THE HONORABLE CHARLES B. RANGEL
SUBCOMMITTEE ON TRADE
HEARING ON IMPLEMENTATION OF THE URUGUAY ROUND TRADE AGREEMENTS
AND THE WORLD TRADE ORGANIZATION
MARCH 13, 1996

Mr. Chairman, I commend you for holding these hearings today and for announcing your intent to hold a series of hearings throughout 1996 on the status and future direction of U.S. trade policy. There continues to be a great deal of discussion in this country on whether our current trade policies are adequate or require partial or wholesale adjustment. I would expect this debate about trade policy to continue -- indeed, this is a subject that Americans have been debating for over 200 years.

As you noted, the Uruguay Round trade agreements are the broadest, most comprehensive multilateral trade agreements in history. However, they were not without controversy in this country and in this Congress. Nonetheless, these agreements do hold the potential for increased U.S. exports, greater economic growth, and more effective international dispute settlement if properly implemented. If the United States is to take full advantage of the Uruguay Round trade agreements and to ensure the proper functioning of the new World Trade Organization, it is essential that the Congress and this Subcommittee remain actively engaged in overseeing the implementation and operation of these agreements and the WTO.

Indeed, the Congressional role in this implementation process was spelled out in great detail in the Uruguay Round Agreements Act of 1994. For example, there are extensive provisions that require the Administration to notify and consult with the Congress on U.S. positions in dispute settlement proceedings before the WTO. In particular, USTR must consult with this Committee on any panel report adverse to the United States on whether to implement the findings of such report, and if so, the manner and timing for such implementation. Another provision requires USTR to submit an annual report on WTO activities to Congress. The first such annual report is due from the Administration shortly. Yet another provision calls for a review of continued U.S. participation in the WTO every five years. At such time, Congress may vote, based on a privileged motion offered by any Member, on whether to disapprove continued participation by the United States in the WTO. There are still other provisions which define the role of Congress as an equal partner with the Executive branch in the implementation and operation of these agreements.

I welcome Ambassador Kantor, former U.S. Trade Representative Yeutter, and our other witnesses today. I look forward to hearing their assessment of whether we are on track in the implementation of these agreements; any problems that have arisen and how those problems should be addressed; and prospects for the future.

Again, thank you for holding these hearings, Mr. Chairman. I look forward to working with you on this important subject.

Ambassador KANTOR. Thank you very much, Mr. Rangel.

I appreciate your very kind remarks. None of this could have been done without your help and the help of your colleagues. No one does this alone.

We still have major challenges, and you cited the most difficult one as the transition we are making and how it affects the American people and our workers.

We are trying to address that on a bipartisan basis, I think, by standing up for the American people and our workers, but making sure the rules are fair as far as not only they are concerned, but they are fair as far as our companies are concerned. As we break down barriers, what we really do is, of course, give access to other markets, as others have had to our market, which means we export more—not jobs, but goods, not jobs, but services, and that is what we really want to accomplish, and I think we are getting there.

We have not solved every problem, and let me say I would be the first one to say that that is the case, but we are on our way if we just continue, as you correctly said, as the Chairman said, that we stick together and operate in a bipartisan fashion.

We are not going to agree on everything. Any year divisible by four is a tender year in American politics. I understand that. The President understands that, but we will continue to try to work together because it is in the interest of the American people.

Chairman CRANE. Thank you.

Mr. Kantor, as a followup on this subject, I understand there is a fair amount of controversy surrounding the U.S. efforts to establish a WTO working party on labor issues. How do you anticipate dealing with labor issues within the context of the WTO, and what do you anticipate the administration's position on this issue will be, and what kind of support do we have from our trading partners for this position?

Ambassador KANTOR. I think it is section 131, if I am not mistaken, of the Uruguay Round Agreement Act, which implores us to go forward with the intersection of labor and trade.

We are following that. We believe in it. We agree with it. It is important we make progress.

We have made it clear to our trading partners, the members of the WTO, the 117 nations, that, in fact, this is an important part of making sure we level the playingfield, as others don't protect against the use of child labor or forced labor, as they don't provide freedom of association and the right to collectively bargain, as they discriminate—some discriminate—in their workplaces with regard to certain groups in their society. We need to make sure we address those issues because, clearly, if you just put this in economic terms, I understand there are very sensitive human terms here, but let me just for the moment address only the economic issue.

It gives those operating in that environment a major advantage over our companies and our workers, and we shouldn't allow that. That is not comparative advantage. That is unfair advantage, not the least to say how it affects people in that society.

So we are going to try to continue to move forward. It is part of a whole series of issues. I indicated we would try to have more market access and reach an agreement, hopefully, at Singapore, especially in the Information Technology Agreement on antitrust pol-

icy or addressing that issue in the WTO in terms of protecting investment, also in terms of bribery and corruption. It has become a major problem, frankly, in international trade.

We will have a report from the Trade and Environment Committee which has been set up, as you know, under the WTO with U.S. leadership in three administrations. So we look forward to addressing all those issues at Singapore.

Chairman CRANE. Following up on that point, I understand the Uruguay Round Agreement has referred to a built-in agenda for the WTO, and I know it is a long list, but I was wondering if you could highlight for the Subcommittee what you see as the most important priorities for the United States.

Ambassador KANTOR. The most important priorities we have are, number one, to ensure the WTO, as established by the Uruguay Round, is a constant forum for opening markets and addressing these problems.

Let me explain that. It is the most important part of this. In the past, the GATT would wait for ministerial to ministerial in order to address very large issues and then create very high expectations which, of course, was sometimes frustrating and oftentimes not as effective as a day-to-day addressing of these issues.

So we hope and trust, and it is operating that way now, that the operation in Geneva and our Ambassadors there continue to address these issues on a day-to-day basis. Number two would be market access; number three, the other issues I just articulated for you. All of those will be issues we address on a daily basis, literally, but hopefully, at Singapore, when all the Ministers gather, we can make more progress.

I guess my point is we shouldn't allow the Singapore Ministerial to become the only issue in the WTO because it raises expectations too high. Frequently, of course, it is not the appropriate forum because of the numbers of Ministers there that make real progress.

Hopefully, based on consensus, which is the way the WTO operates, we can move these issues forward on a daily basis in Geneva.

Chairman CRANE. One of the goals of the Uruguay Round was to liberalize trade in textiles by phasing out quotas for this industry over 10 years. Yet, under the WTO textile agreement, the United States sought to establish 26 new quotas in 1995. In light of the fact no other country made a single textile call, it seems to me to be an abuse of the safeguard provision of the textile agreement.

Can you please comment on that?

Ambassador KANTOR. We are well within our rights, Mr. Chairman, to make sure other countries live up to their obligations under the textile and multifiber arrangement, which you know is phased out over 10 years.

As you know, the tariff cuts were fairly low in this area; we had to implement about 11 percent on the average, 11.4 if I am not mistaken.

The fact is we are going to make sure our industries, textile apparel and others, remain competitive while we implement this agreement. The 10 years is well set. We will live by that agreement, but while we are doing it, we will also live within our rights to make sure other economies aren't taking advantage of the

progress we have made to make our industries less competitive and less able to make the transition.

Let me indicate that in the textile industry over the last 3 years, production is up. We are impacting and getting into foreign markets. We are insisting on market access, and we are going to make sure as we phase out the multifiber arrangement that others open up their economies to our products to allow us to compete.

I believe our workers in both textiles and apparels can compete, given the new capital investment in the way in which our companies operate, if we have fair rules, and that is what we are insisting upon.

So we are going to continue on that path because I think it is the most important progress we can make in this area.

Chairman CRANE. Thank you, Mr. Ambassador.

Mr. Rangel.

Mr. RANGEL. Because of my obvious fondness for asking the question about what motivated the administration to change its mind on Helms-Burton——

Ambassador KANTOR. I'm sorry, Mr. Rangel. What? I'm sorry. I didn't hear the last part.

Mr. RANGEL. I said I am not going to ask you the reasoning behind the administration changing its mind on the Helms-Burton bill, but if I read it correctly, it seems as though it causes some conflict not with foreign policy alone, but our trade obligations under GATT, as well as NAFTA.

In view of the fact we are trying to get China in the WTO and Cuba is there, and we are trying to expand our trade with Communist countries, how do you negotiate through dealing with our friends and trading partners and Mexico and Canada and Europe with the new law that has been enacted?

Ambassador KANTOR. Under both the NAFTA and the Uruguay Round Agreements, we reserve the right to do two things. Number one, to protect the security interests of the United States of America in this regard, and number two, to ensure we could control our borders to the emigration of persons into the United States who were committing crimes of moral turpitude.

Mr. RANGEL. In the first instance, you are suggesting that Cuba is a threat to our national security?

Ambassador KANTOR. Our national security interests, we believe, are affected by what happened with this serious and tragic occurrence in international air space over international waters, and therefore, we believe the Helms-Burton bill and the way it has been drafted and the President signing it is consistent with our international obligations.

Mr. RANGEL. You find no problem in dealing with our trading partners? You think this Helms-Burton bill is consistent with the treaties you have participated in and negotiated?

Ambassador KANTOR. Our trading partners haven't thoroughly agreed with our approach, as you probably know, but frequently, we have interesting conversations over certain things we do.

The fact is I believe, legally, we are well within our obligations under NAFTA and the Uruguay Round, and therefore, we are on solid ground as we advocate the Helms-Burton bill does not violate our international obligations in this regard.

Mr. RANGEL. I won't pursue this because I have not found any people that worked in trade or in the State Department's Latin American policy area that believe the Helms-Burton bill is in the best interest of the United States, even though that was not their position under previous administrations.

So I suspect a part of your job is to support the policy of the United States of America, whether you agree or whether you disagree with it.

Ambassador KANTOR. In this case, Mr. Rangel, you and I may disagree, but I agree with not only the policy, but I support the President in his signing the bill. I think it is an important signal, and again, as I say, it is fully consistent with our obligations.

Mr. RANGEL. Did you believe in the President's objection to this bill before those heroic pilots were shot out of the air and murdered by this Communist dictator in Cuba before he committed this atrocity? Did you then agree with the President that this was a bad bill for the United States?

Ambassador KANTOR. The bill had changed. We, of course, objected, as you know, to many portions of this bill, and it was changed in a fairly profound way. Therefore, we now believe it is consistent with our obligations.

Mr. RANGEL. You believe making the embargo laws statutory, which can only be changed by the Congress now rather than the President, is consistent with what is in the best interest of the United States?

Ambassador KANTOR. I am going to let Secretary Christopher speak to the larger issue, but in terms of trade, our trade obligations are fully consistent, as far as I am concerned. Yes, sir.

Mr. RANGEL. Thank you.

Chairman CRANE. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

I will concur in part And dissent in part in Mr. Rangel's introduction. I don't know if you are ready as a headliner for opening a new Planet Hollywood, but you have done a really good job.

We were talking the other day about how ironic it is that, just a few short years ago, we were complaining that not only were the rules unfair, but we had a disadvantage because we kept changing our key people in the area of trade vis-a-vis other countries around the world. It is pretty obvious we now have a degree of stability that some of the other countries we tended to focus on who we thought had an advantage have not.

As far as the rules are concerned, many of us supported GATT in the hopes that the rules change would be fairer in a larger sense and not just narrowly for the United States, notwithstanding the fact that we wound up naming this operation what I considered to be a dumb name. It was like when they talked about setting up public broadcasting, and they were trying to figure out a name for it, and people said, Well, no one would be dumb enough to call it the "Public Broadcasting System," and we have got PBS.

So we have got WTO, the World Trade Organization, which I don't think is the best name we could have picked, but we have got it.

We have been in it for 1 year, and what I would like you to do for what short time I have is to just use maybe a couple of exam-

ples to encourage and inform us that the rules have made a difference.

Two areas I have been concerned about for sometime is obviously the United States and Japan relations vis-a-vis a number of products.

We have a current nominee among our disputes in terms of distilled spirits with the Japanese. That would be a specific subject matter.

Perhaps an even better example would be the United States/European Union ongoing difficulties over beef with BST, which was a classic stalling tactic, in my opinion, on the part of the Europeans utilizing political levels, rather than any scientific findings.

Could you, if it is possible, use just those two examples to give me a feeling that, in fact, my vote was worth something, it has made a difference, and there does appear to be not just an ability to come out in what we believe to be the right, if we are to prevail, but that there will, in fact, be an ending to the process, which I think was one of the disturbing features of the previous structure, that, in fact, if folks wanted to stall, they could stall forever?

Ambassador KANTOR. Exactly.

Mr. THOMAS. I assume that is not now the case. Could we use those two examples as an example of why we are better off having passed GATT than before?

Ambassador KANTOR. Number one, the most difficult feature of the GATT for 46 years was that even though you might prevail in a dispute settlement, the country who was the so-called loser could block a ruling.

We were the most active in 46 years, the most active country in bringing cases. I think it was over 50 percent of the cases were brought up by the United States. We won about 80 percent of those. However, time after time, we were frustrated at the country that did not prevail, would block, as they have a right to do under the old GATT, the ruling.

This is not the case, as you well know, under the Uruguay Round. You can no longer block. In order, in fact, for a ruling to be blocked, all countries, including the preventing country, must agree. So we have turned it literally on its head.

Number two, the Dispute Settlement Understanding makes for a more due process, quicker decisions, automatic right of appeal, but the decisionmaking process is much more efficient, and frankly, I think effective.

Number three, of course, I can give you some very quick examples already where it has made a difference.

We brought a case on grains, rice being part of that, against the European Union. We reached a settlement because they realized we were going to prevail in this very efficient procedure, and of course, now we have more access to the European market and have avoided a problem in the way they evaluated tariffs on grains which have been, we think, in violation of the Uruguay Round obligations.

Mr. THOMAS. Mr. Kantor, I think that is a point we need to underscore because, although we like a structure that will allow us to come to a conclusion, the certainty of the result will result in, I think a way of putting it, more settlements out of court.

So it isn't the fact we prevail in the cases. It may, in fact, be how many never reach that stage because of the certainty of the structure, which is a significant difference.

Ambassador KANTOR. Yes, sir, Mr. Thomas. Let me give you two more examples of that.

Korea on shelf life, so to speak, for allowing beef and pork into Korea, they were discriminating against United States products. We brought a case, and we reached a settlement very quickly after we brought the case.

We now have indications that our case we brought against Japan on their failure to implement under the TRIPs Agreement, their obligation to protect sound recordings for 50 years, the Japanese have now indicated they are willing to live by that obligation.

Now, we haven't received anything officially in writing, although we have had oral communications which indicate that.

So those are three very quick examples over the first year.

We have filed 10 cases. Again, we have filed more cases than any other country. Depending on what Japan is, either seven or eight are pending. Our latest, of course, is we have brought a case against Canada for discrimination against United States split run, so-called split run magazines in their country. I believe this is working well.

Let me just mention one other thing.

Mr. THOMAS. Mr. Kantor, the light is not on, but I am mindful of the time and other colleagues who would like to question you. I had asked about two specific cases, Japan/United States distilled spirits, European Union/United States on BST beef hormone. Where are we on those?

Ambassador KANTOR. We have brought a case on both. We have gone through the consultation period. I am not sure if panels have been implemented on both yet or not.

Mr. THOMAS. Can anyone give you a feeling for the attitude of the Europeans?

The attitude of the Europeans on BST to me would be a nice temperature-taker of the change.

Ambassador KANTOR. In that regard, we are making some progress there, I believe. We have had a problem with the Europeans on not only that, but the so-called roundup already made by Monsanto. The Europeans have broken, frankly, the logjam in that regard of going out to the member States for approval. We believe that will be approved by the European Union. So we are making progress.

We have not solved all our problems. I hope I didn't indicate that.

As far as the distilled spirits, we are in our second hearing now, and we hope to have a fairly quick decision on that.

Mr. THOMAS. Do we have a timeframe at all for a conclusion of either of those?

Ambassador KANTOR. We have an estimated timeframe, and I would be glad to submit that for the record.

On distilled spirits, we believe the final report should be around July 7. Now, it could be either earlier or later, but that is about it.

The second submission has been due and done. The second panel meeting is March 18. Then we will have an interim panel report, a final report, and then the circulation by July 7. So that is very quick.

Mr. THOMAS. Yes.

Ambassador KANTOR. Of course, in sharp contrast, as you know so well, to what has happened previously.

Mr. THOMAS. Thank you very much.

If you would, submit for the record any timetables or time periods that you estimate on the bovine semitropin.

I appreciate it.

Ambassador KANTOR. Thank you very much, Mr. Thomas.

Mr. THOMAS. Thank you.

[The information was not available at the time of printing.]

Chairman CRANE. Mr. Gibbons.

Mr. GIBBONS. Mr. Kantor, you are doing a fine job, and I support what you are doing. I am proud to say you began your distinguished public service career as a worker in Florida's vegetable fields, applying legal justice for very poor people, and you have come a long way since that time.

I want to talk about trade in general, but you have covered that so well. Let me talk specifically about one part of the services that we provide.

As we all know, European imperialism died rather slowly, particularly when it helped somebody's pocketbook, and the Europeans have long helped their pocketbook by discriminatory trade practices with their former colonies.

I think the best example of that today is their preference for bananas from certain parts of Central and South America.

We have had actions against the Europeans on this. I think there have been findings by the GATT that their practices are illegal. Can you tell me what progress we are making and what public information you can give about your time schedule on taking further action against the Europeans on that issue?

Ambassador KANTOR. Thank you, Mr. Gibbons.

I think it would be untoward of me not to recognize in public the fact that you are retiring after 36 years, and your leadership will be sorely missed. You have been a strong clear voice for American trade policy and American workers, and all of us appreciate it.

You have given so much of your life to public service, including in the Second World War in which you won a Bronze Star, if I am not mistaken.

I just know I, for one, will miss your guidance and your help, and I hope I still can call on you after this session of Congress is over.

Mr. GIBBONS. I will be happy to do anything I can to help.

Ambassador KANTOR. Thank you.

On bananas, this goes back, frankly, to Mr. Thomas' question, to some degree.

Mr. GIBBONS. Yes.

Ambassador KANTOR. There were two GATT rulings on behalf of the Latin American countries with regard to European discrimination, with regard to bananas from Latin America, discriminating in favor, of course, of what they call their former colonies. These are

the Canary Islands, the African countries, and the Eastern Caribbean countries.

We have now brought under the new dispute settlement mechanism a case versus the Europeans for discrimination in their market against the Latin American bananas.

On the one hand, let me make it clear, we have provided a waiver so they can give preferences to the Eastern Caribbean countries and African countries and the Canary Islands.

On the other hand, they do not have to discriminate against Latin American countries to do that. So we have tried to walk the line between recognizing the need in these smaller economies to continue the banana trade with Europe, at the same time to try to use dispute settlement to change European policies and practices which are discriminating right now against Latin American countries.

Four Latin American countries have joined us in that. I believe we are going to prevail in that matter. It can't be blocked, as it was twice blocked under the GATT.

Recently, I met with the Ambassadors of all the Eastern Caribbean countries who were stationed here in Washington. We had a good meeting. They, of course, would like the Europeans to come to the table and resolve this. We would welcome a resolution which is not only in the best interest of Latin American countries and the Eastern Caribbean, but also the thousands of American workers and very large companies whose jobs depend on this banana trade.

So we are trying to balance these interests, but if the Europeans are unable or unwilling to come to the table, we will pursue this case, and I believe we will prevail.

Mr. GIBBONS. Thank you.

Let me float one question more about expanding our trade agreements with countries in this hemisphere, and really anyplace else. We have got a standoff between the administration and the leadership in Congress here over fast track.

I don't possess the power nor the qualities to be a settler of these disputes, but as you know, I have suggested to you and suggested to others here on the Hill that what we perhaps ought to do is reach a compromise on how we work out our differences.

Essentially, you and the President want to include in fast track negotiations for labor standards and for environmental standards, and our Republican colleagues won't have any of that under fast track.

I have suggested there be a compromise; that you be allowed to negotiate labor and environmental concerns during the regulations and you can submit them back to Congress under fast track, but a fast track that is disconnected from the trade fast track.

It would happen, perhaps, at the same time. Certainly, it ought to happen at the same time, but there would be two separate votes under fast track, one on the trade package and one on the environmental and labor package.

I don't know any other way around the political standoff that we have here in this government unless we do something like that.

Now, I know we don't have time enough to work it all out here today, but I would like to hear from you as to what you think could be done in that area.

Ambassador KANTOR. Thank you, Mr. Gibbons.

I believe it is in the best interest of the country that we move forward in order to deal with Chile's desire to accede to the NAFTA.

The Chilean economy, of course, is very impressive, and they have built a very strong democracy under both President Aylwin and President Frei. Last year, they had, it is interesting, 10 percent growth and 4 percent unemployment and a trade surplus and a budget surplus. I am very jealous of those numbers. We all should be.

On the other hand, in order to continue that and to build confidence in Latin America, if you just look at those numbers and you see how important Latin America is going to be to us in the future and to our workers, we need to continue to build that confidence.

In both ways, the accession of Chile is important. I believe Chile's accession is widely supported here in the Congress by Democrats and Republicans. I think I can make that statement without fear of contradiction.

I would hope we could reach a rational understanding—it may be difficult—over the next few months to gain fast track authorization to negotiate with Chile in order to move forward. I understand the difficulties.

Without particularly remarking on your creative proposal, let me just say there ought to be a way to try to address this that preserves your negotiators, and I say "your" because we all know the history of USTR—it is as much a creature of this Congress as it is of the executive branch—your negotiators with flexibility to reach agreements which are in the best interests of the country, which you then review and either pass on or not. At the same time, not in any way create a situation in which one side or the other believes they have been adversely affected by the compromise.

So I am prepared to continue to try to work with the Chairman, with Members of the Subcommittee, with the Chairman of the Full Committee, as well as the leadership to try to reach such a compromise.

Mr. GIBBONS. Thank you.

Thank you, Mr. Chairman.

Chairman CRANE. Mr. Houghton.

Mr. HOUGHTON. Thank you.

Mr. Ambassador, it is good to have you here. Thanks very much for being with us and also doing the great job you are doing.

I have several questions. I don't know whether they require a great lengthy answer.

First of all, I am concerned about China and the WTO. You could see this cloud looming over the horizon, and I just wonder whether there are any safeguard mechanisms which were included in the WTO Agreement.

The next issue is really what the President said in his economic report, and I have a quote here, and I am sure you know this. "The continuing external deficit remains a cause for concern, but it must be kept in mind that the deficit is caused by macroeconomic factors, not trade policy."

That is a little confusing to me because I always have linked those two things together.

Also, Congressman Levin and I introduced a bill last year, H.R. 1434, which basically is a companion bill to the one Senator Dole introduced in the Senate, and I don't know whether you think that is a good idea. I think you did last year. I want to know how the administration feels about it.

So those are three questions.

Ambassador KANTOR. On China, we support China's accession to the WTO, but on a commercially reasonable basis. There are certain foundation principles of the WTO—I will use an example, transparency—that every country must adhere to, and China should not be exempt from those requirements.

On the other hand, for certain purposes, China, of course, is a developed nation. For others, they are a developing nation, and there needs to be some practical and pragmatic decisions made.

We have put on the table a road map for China. In October of this year, we have several meetings with the Chinese during and since that road map on the WTO accession.

Clearly, the ball is in their court at this moment. They have not addressed all the issues in that road map, we believe, as they said it was helpful to them, and we hope this will move forward. However, there are still some very important issues to be addressed.

On macroeconomic issues and trade and how much influence one has over the other, as we become more interdependent and globalized, the more complicated issues such as how does macroeconomics and exchange rates affect trade versus trade agreements versus the competitiveness of your workers and your businesses versus unfair trade practices. All of those matters have an influence on whether you make progress or don't make progress.

Frankly, in a number of ways, we can see we are making progress, even though you would say in certain cases the macroeconomic factors might be moving in a different direction.

For instance, in the automobile industry, from January 1993 to January 1996, we have made great progress, and 773,000 people were employed in January of 1993. It is now 920,000. We are now the greatest producer of automobiles in the world, and the percentage of sales of imported cars in the United States has dropped from merely 24 percent to a little over 17 percent in that same period of time.

So, as the percentage of imports to sales drops and our production goes up and our employment goes up, you can see how we are making progress.

Macroeconomic factors in some cases, notwithstanding, as you know, as our economy has been the strongest among the G–7 countries and much stronger than our major trading partners, that should mean that, in fact, we are drawing in more imports than we are creating exports.

The fact is the opposite is beginning to happen, as my chart indicates. So it is a complicated set of circumstances that needs to be continually reviewed, and there is no simple, single answer.

I think H.R. 1434 is the Dole Commission, is the way it is referred to. We support it. We worked with Senator Dole on it. It is a good idea. The ability to set up a panel that could review adverse decisions by the WTO and make a decision whether or not power was abused or they went outside their authority, I think would be

helpful in giving the American people the confidence that the WTO and its dispute settlement mechanism are working in an appropriate fashion.

So we support it. We continue to hope we could pursue that in this Congress.

Mr. HOUGHTON. If I could just follow up on this second question, the macroeconomic policy versus trade policy. As you and I know, the reason you are doing such a great job is because trade policy is very important, and trade policy has to do with things like structural deficits.

The reason consumer electronics left this country for a long time is not macroeconomic. The reason the automotive industry slipped so badly was not macroeconomic.

So I just hope the powers that be at the White House are not thinking this is something entirely separate from the important work you are doing and the trade policies we are trying to establish.

Ambassador KANTOR. Mr. Houghton, this President understands clearly the connection between our demanding a level playingfield and making the rules fair and insisting on equal access to foreign markets connected to a strong U.S. economy in order to continue to make progress and building jobs, raising our standard of living, and making sure we can create the capital to continue to progress.

It is interesting. If you did a market study, as I indicated before, we are 4 percent of the world's population. That means 96 percent of our potential consumers live outside our borders.

As their economic power grows, which it certainly will over the next number of years, that is good news. In other words, they will be more and more industrialized and grow a middle class. They become our consumers of the future, and we need to take advantage of that.

You have been a great supporter of it. We agree with you in this administration. It is an important part of what we are going to do if we are going to continue to build our economy here at home.

Chairman CRANE. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Ambassador, I would like to follow up on Chairman Crane's line of questioning earlier relative to the working parties called for under section 131.

Has a working party been established relative to worker rights as yet?

Ambassador KANTOR. No, it hasn't. No, sir.

We had a commitment at Marrakesh based on a consensus—that means everyone—that we would begin to address this issue.

Let me be extremely candid here. There has been tremendous resistance, especially from developing economies, to having a working group on worker rights which they have indicated they believe is a disguised form or could be a disguised form of so-called "protectionism." Frankly, those countries which are most opposed are those countries where we are most concerned about their worker rights and also concerned about their open markets. There seems to be a direct correlation between the two. However, we are making progress.

We have had a number of good meetings in Geneva. Ambassador Lang has done a marvelous job in pursuing this issue, as has Ambassador Gardner and his folks in Geneva, and we are making progress. We don't have a consensus yet.

We have indicated, though, as others want to move forward in terms of investment policy and our working group on investments in the WTO or the competition policy, we are going to insist we move on worker rights and trade and how they intersect as well.

I believe we can make some progress in this area. I believe for the first time since 1947 we can make this concern, which has been a concern of every U.S. President since President Eisenhower—they have taken exactly the same position—bring it to reality and have a working group established.

Mr. COYNE. Could you tell us which nations have supported the formation of the working party?

Ambassador KANTOR. We have made great progress with our European allies. As you know, there was great concern in Europe when we first raised this issue in this administration. Only France was supportive at first. We now have a European Union position which is supportive. That is a major step in the right direction.

Mr. COYNE. Thank you.

Chairman CRANE. Mr. Hancock.

Mr. HANCOCK. No.

Chairman CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Ambassador, it is good to see you again.

Ambassador KANTOR. It is good to see you.

Mr. RAMSTAD. I note from your chart something that is evident to most people. Our future for export growth lies in the Asian nations, excluding, of course, Japan, and also in Latin America.

What in your view, Mr. Ambassador, is the most significant barrier to U.S. exports in those markets, and how in the context of the WTO and the Uruguay Round Agreements can this concern best be addressed?

Ambassador KANTOR. Number one, of course, is to make sure we continue to lower tariffs and nontariff barriers, such as quotas or licensing requirements or other.

Number two would be to address issues such as, frankly, people joining the procurement agreement, being more transparent in the government procurement, and also dealing with the issue of bribery and corruption.

Number three is to begin to make sure their internal rules, whether it is competition policy or protecting investment, of course, progress and we have a level playingfield in those markets.

We have made progress. Of course, we increased our exports to Asia, outside of Japan, by 23 percent; by the way, Japan, by 20 percent, in 1995. That is a huge increase in exports. We can't expect that to happen every year, but frankly, the combination of the Uruguay Round and our fairly aggressive behavior in terms of bilateral discussions, as well as the APEC meetings and the President reinvigorating APEC, have really made a difference.

Mr. RAMSTAD. So you would concur that the last thing we need to do, as some on the Presidential tour are suggesting, is to create

more barriers and higher tariffs, rather than go in the direction of freer trade.

Ambassador KANTOR. It is a matter of fair trade.

The last thing we should do is cutoff our market to others goods and services. What we need to do is insist we have equal and fair access to others markets.

The fact is we are no longer a self-contained economy. As much as all of us might want nostalgically to look back in the time past when we were self-contained, that doesn't exist. We need to compete. We need to win in the global economy. The only way to do that is to make the rules fair.

By retreating and hiding behind fear, so to speak, all we are going to do is cut ourselves off from the fastest growing markets in the world and cost us jobs, not create jobs.

Mr. RAMSTAD. Mr. Chairman and Mr. Ambassador, I appreciate that recognition on your part and also on the part of most of the Members of this Subcommittee in a bipartisan spirit. We have addressed these issues.

I have just one final question because it concerns a number of companies in my district and, indeed, around the country.

In the Uruguay Round Agreements, is there a specific mechanism that would help us address the intellectual property rights abuses through the WTO?

Ambassador KANTOR. Yes, there is. We have for the first time, as you know, a TRIPs Agreement, intellectual property agreement, which sets a baseline of standards that, first, developed nations had to meet as of January 1 of this year, and developing nations have a 5-year runup to meeting all the standards, although they have to enforce their current laws under this agreement.

The fact is we have brought a case against Japan on sound recordings. We have reached two agreements recently with Japan on, frankly, their failure to meet certain standards and protecting patents and other areas, which I know is some concern to you and your constituents.

We have not solved all of our problems with Japan. We still have some concerns and will continue to work on it.

We have made it clear to our Japanese interlocutors that we are not going to wait forever for them to respond to their obligations under this agreement.

Mr. RAMSTAD. Thank you, Mr. Ambassador.

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Welcome, Mr. Ambassador, and I, too, want to add to the comments of my colleagues about the fine job that you have done, and your staff as well.

I think there is one remark you make that bears repeating, and this speaks very well of what you and the administration have done, and that is that in the last year, exports grew at a faster rate than did our imports. It is my understanding this is the first year that this has happened in a very long time. I don't know when that might have happened before, but it has certainly been a while since that has occurred.

At least part of that is certainly due to good trade policies and trade policies that we on a bipartisan basis have worked on with you and with this administration.

I wanted to return to a subject you spoke about briefly in response to the Chairman's question having to do with textile and apparel goods. This is a subject that is very important to me because I represent a district that has a number of such firms, and roughly 50,000 people in my district work in the textile and apparel industry.

You mentioned we did implement as part of the Uruguay Round a 10-year phaseout of our quotas. We recognize that that is going to cause some job loss, and we recognize that we need in the interim to do all we can to make sure our industry is as competitive as it can be, and enforcing the rules certainly is an important part of that.

This Subcommittee had voted as we were moving through that process to conform our rules of origin to those of our trading partners, namely the European Community and Canada and Mexico. That was pretty overwhelming. I remember the vote was 24 to 12.

I and some others have some concerns about the implementation of those rules, and specifically that we are not creating loopholes in those rules as a result of the ruling process at Customs or that these rules don't get circumvented by quota compensation negotiations.

Would you comment on the implementation of these important rules?

Ambassador KANTOR. In many ways, we have made it quite clear in this area, especially, we are going to protect the competitive ability of our industry. In terms of this rule of origin, it certainly went to an assembly rule, which this Subcommittee voted for and the administration supported. The rules of origin would be implemented on July 1, as required by the act.

Ambassador-Designate Hayes intends to work closely with Customs and Commerce colleagues to provide appropriate policy guidance in this process, consistent with the objective of an assembly rule of origin.

As far as compensation negotiations are concerned, we intend to proceed carefully and responsibly. Our trading partners must come to the table, I want to make this clear, with the burden of proof on them that there has been a change in the rules that disrupts their trade or their access. The burden of proof is not on the United States.

Mr. PAYNE. Thank you for that answer, and I do appreciate that.

The other part of this equation is, How is it that we can be as successful as possible selling in other markets around the world, and you alluded to that earlier; what are we doing to ensure that in this industry, again, the textile and apparel industry, that we can be as successful as we might be in terms of being able to export our goods to other markets?

Ambassador KANTOR. In the negotiations in 1993, we made it clear that as we agreed to a 10-year phaseout that we needed provisions in the Uruguay Round, which made it clear if we did not get effective market access, we could react in a way that would not

result in the reduction of quota growth or the increase in quota growth for other countries.

We have been very vigorous in pursuing this, both under the Uruguay Round Agreements and also bilaterally.

As you know, Mr. Payne, and you have been a great advocate of this, China was exporting textiles to the United States over the last 7 or 8 years, before 1994, and we reached a new bilateral agreement at a rate of about a 14-percent increase a year.

Since we reached our new bilateral agreement which requires China to have a 1-percent textile growth in year one and zero in the next 3 years, in fact, China's textile and apparel exports to the United States have gone down by 3 or 4 percent. So, we are making progress because we have been focused and disciplined about keeping the industry competitive and not allowing circumvention and transshipments in violation of our quotas.

However, we are going to insist on market access as a tradeoff, as a tradeoff for the phaseout of the MFA, and we, as I said, have protection in the Uruguay Round for that policy.

Mr. PAYNE. Regarding the policy, the bilateral with China, it is my understanding this will expire at the end of this year, 1996, and it is my feeling that what we need to do is we continue these discussions with China's succession to the WTO and to maintain our discussions or start our discussions with that agreement and not to the pre-1994 agreements that we had.

I thank you very much for that, and I thank you very much for the good work that you are doing.

Thank you.

Ambassador KANTOR. Mr. Payne, thank you for all of your personal support, as well as the support up here. I know you will be leaving as well. We will miss you, and I hope, like Mr. Gibbons, I will get both of your phone numbers and keep calling you.

Mr. PAYNE. Thank you very much. I would like to do that.

Chairman CRANE. Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman.

I, too, would like to express my appreciation for the availability and the good work that you have done, Mr. Ambassador, in working with some of our Florida problems. I am not going to ask any questions with regard to that this morning.

I am concerned, however, with a World Trade Organization granting of a Venezuelan complaint about the baseline on the pollutants and the gasoline.

As you know, Congress passed a bill, and it was signed in law by the President, that would set these standards.

I am very concerned. I don't know the full significance of this particular ruling as it applies to the specific case, but I am very concerned that the World Trade Organization could in any way affect the environmental laws as defined by Congress and to be enforced by the President and the EPA with regard to these standards.

Could you tell us exactly where does a World Trade Organization claim to have this authority? I know this case is on appeal, and I would like also to get some thoughts from you as to if we should fail on the appeal, where we would go from there.

Ambassador KANTOR. Thank you, Mr. Shaw.

If I could make a couple of broad comments about it which address this issue directly and then talk specifically about the reformulated gas situation.

Just to go back to the discussion early on that we went through in 1994 about sovereignty, and that is what this really hits on, as you know, no substantive right or obligation in the United States of America can be affected in any way by this WTO without our consent, no substantive right or obligation.

Second, the WTO does not in any way affect the ability of the United States to pass its own laws, to enforce existing laws, or to set its own environmental or health standards.

Now, specifically on this decision, the panel says directly in its report, they are not passing judgment in any way on our Clean Air Act. They are only passing judgment on one aspect of one rule which they believe does not provide national treatment.

We have appealed that, as you know. We filed our notice of appeal on February 21. We, on March 4, submitted our brief. The Venezuelan brief is due on the 18th of March. There will be oral arguments later this month. Then, on April 21, we assume there will be an appellate report.

We think we have a reasonable chance to prevail. However, I want to make it clear, no matter what the decision, it is up to the Congress of the United States and our elected leaders to make decisions whether or not we change our laws. The WTO cannot affect that in any way.

Mr. SHAW. Then what we are looking at is a decision or ruling that really has no teeth in it. Is there a penalty we pay if we walk away from this?

Ambassador KANTOR. There are two or three things that can happen at the end of this process.

If, in fact, any country is the subject of an adverse ruling, they can either, number one, comply—that is one alternative. In this case, it would be change the rule, although let me make it clear for the record, we expect to prevail. Number two, you can enter negotiations, in fact, they are encouraged, over a period of time with the prevailing country, any country that loses a decision to see if you can reach some understanding or some compromise; or number three, you can go ahead and allow the country, and in this case, it would be very small, to take trade action in the amount of what is the loss the panel decides is relevant. The fact is, in this case, there is very little, in terms of dollars, at stake. So we would have a number of options were we not to prevail in this case.

Mr. SHAW. Let me switch subjects with you in an area that I know you have also been working, and this is the area of corruption and bribery, something that is really a way of life in parts of the world that our citizens are precluded by law from engaging in.

I know you are trying to get more and more people, more and more countries to come over to the standards we have set for our businesspeople in the foreign negotiations.

Where are we on that? Are we making some progress?

Ambassador KANTOR. We are making some. As you know, I am not the world's most patient person, and so it is a little slow for me, but for others who have been involved in this business longer than I have, they believe we are making strides.

We went to the OECD early in this administration, that is, the industrialized nations of the world whose offices are in Paris, and recommended they take two actions, to recommend to the OECD members that, number one, they recommend to the countries that they rescind laws that allow countries, and there are 14 now, who allow their citizens or corporations to deduct off their taxes payments made in lieu of bribery or corruption. We find that unacceptable, and we believe the OECD in our meetings in late May will adopt such a recommendation, and we hope that all OECD members will comply with that recommendation.

Number two, of course, we have advocated vigorously that the OECD also recommend all these countries do what we, the only country in the world, have done, pass what we call the Foreign Corrupt Practices Act and criminalize behavior on the part of individuals of corporations who engage in these type of practices.

Number three, we believe it would be helpful if more and more countries joined the procurement agreement under the WTO and, in fact, implemented more transparent regulations in procurement practices.

Last, of course, it would also be helpful, although this is not directly involved—we have found a direct correlation between the more control a government has over its industries and its economy, the more you find the prevalence of bribery and corruption; that the privatization of industries makes a difference. So, therefore, we continue to urge others to privatize and open up their economies to engage in more transparent behavior, to join the procurement agreement, to criminalize the behavior that we are talking about, and of course, those 14 countries surely—surely, they should rescind their laws and allow people to deduct such payments from their taxes.

Mr. SHAW. I compliment you, by the way, for that initiative. It is tremendously important, and when you talk to our people who do business in other countries, whether they be stationed here or you meet them abroad, that seems to consistently come up because it is very difficult to negotiate business deals when your competition is paying off those in decisionmaking positions in other countries.

Of course, we don't stand for the bribery. We are very much opposed to it, and our law even prohibits it. The morals of the rest of the world really need to come our way, and I compliment you for the work you are doing.

Getting away for just 1 minute from the WTO question which is a hearing process here, could you give us just a brief summary of where we are on the Caribbean Basin Initiative. That is very important to my part of the world down in Florida because of the effect not only on trade, but also the effect on illegal immigration into south Florida.

Ambassador KANTOR. As you know, last year, we supported efforts by Members such as you to try to initiate a Caribbean Basin Initiative which would, of course, allow Caribbean nations under certain circumstances to gain more and more access to this market, consistent with Mexico's access to this market, in terms of reduction of tariffs with regard to textiles, shoes, and other products that they currently do not enjoy under the initiative.

The administration has put in its budget $3 billion to cover over, I think it is, 5 years, a Caribbean Basin Initiative. We have sent over to the White House draft legislation which we assume, and I know the President supports it, will submit to the Congress to try to take another run at this initiative. We think it would be in the best interest not only of the Caribbean countries, but the United States, assuming the right conditions are met.

One of those, of course, is—and I say this because Mr. Rangel is here—that we have for the first time indicated that cooperation with the drug concerns and the export of drugs into this country, illegal drugs, will be part of the conditions that need to be met in order to take part in this initiative.

Mr. SHAW. You have brought us into that subject, and I am going to expand on it for just one moment as to the decertification of Colombia.

I don't know whether this falls into your department or the Department of Commerce more, but what effect will that have on trade with Colombia in that last year decertification was done with the exception of national security, this year it was not?

I compliment the administration for taking that stand with regard to Colombia. I wish we had done so with regard to Mexico, also, but what effect does this have on existing contracts, particularly where you have loans that are already in the pipeline, and how do you view our trade relations with Colombia over the next year based upon the decertification?

Ambassador KANTOR. In answering your first question, as you know, the decertification of Colombia under the act in which a President operated does not directly affect any trade agreements or future trade agreements. It does affect OPIC financing and Eximbank financing in the future.

We hope the Colombian Government will begin to cooperate in the way the act contemplates that we can continue to move forward not only in addressing this critical issue to our country, meaning illegal drugs and drug trafficking. At the same time, we build our economic and trade relations with Colombia.

As you know, I go to Cartagena next week for the third meeting with this hemisphere and try to expand trade in the hemisphere and break down barriers.

We, frankly, had cooperation from the Colombian Government in establishing these meetings and working together. It is a difficult time, but there is no more important issue than stemming the flow of illegal drugs in this country. We will continue to be resolute in working with both sides of the aisle in pursuing that, and this act by the President, of course, this decision, of course, will affect financing of certain contracts, but not directly trade agreements or trade relations.

Mr. SHAW. I thank you for that statement and stating the importance that you place on this because I think there is no question that these countries are turning their backs to the drug trade, and I think you can certainly say it has become just a way of life in that country where the legitimate businesspeople aren't paying much attention to it, and they are not demanding enough of their government to straighten this out.

These countries are nothing but terrorist countries. They are creating more problems for us than those we blacklist because they are manufacturing illegal weapons and other like items.

More of our people have been killed and hurt and lives destroyed in this country from the flow of illegal drugs than have been hurt by the Libyas and the other countries whose behavior is totally unacceptable to the United States, and I think that trade is our best weapon in defending our shores with regard to our relationship to those countries. I compliment you for the importance you put on that and hope you will stick to your guns all through your negotiations with these countries, and not only Colombia, but the other countries, and most specifically, Mexico, which we have had some tremendous problems with, also with 70 percent of the illegal drugs coming in through Mexico according to the administration's own figures.

I, quite frankly, am somewhat confused as to why they were certified because it appears the cooperation we are getting and the corruption that is all through the government down there is just absolutely destroying our efforts to stem the flow of drugs coming into this country which is growing again and is back to epidemic proportions.

I thank you for your good work, sir.

Ambassador KANTOR. Thank you, Mr. Shaw. I appreciate that.

Chairman CRANE. Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Chairman, and I want to acknowledge the work the Ambassador has done as well.

I have a specific question, and it relates to Argentina, specific duties on textiles, footwear, apparel, and the duty that the Argentineans have offered regardless of the value of the goods that are imported.

I don't want to make a judgment until we hear what you have to say, but it appears Argentina's obligations under the WTO are being violated as it relates to footwear. Could you give us an update on that issue?

Ambassador KANTOR. Argentina, as you suggest, established a series of specific duties on textiles, apparel, footwear in September 1995. This new regime requires that a minimum duty be paid on these items, regardless of the value of goods imported.

The regime as currently structured appears to violate their obligations under the Uruguay Round Agreement. We have raised this issue, both in our Embassy and Buenos Aires, as well as the mission in Geneva. We have called on Argentina to either rescind these measures or indicate how it intends to bring the measure into conformity with the WTO or Uruguay Round Agreement.

Compliance with these agreements, the WTO, Uruguay Round, our bilateral agreements, are of critical importance, and I assure you we will take every step in order to enforce these agreements.

Mr. NEAL. I appreciate that reassurance you have offered this morning, Mr. Ambassador, and we will continue to work with you on the subject.

Thank you.

Ambassador KANTOR. Thank you very much, sir.

Chairman CRANE. Does the gentlewoman from Washington wish to inquire?

Ms. DUNN. Thank you, Mr. Chairman.

Ambassador Kantor, I, too, want to thank you for your responsiveness to this Subcommittee. It has been great to have the opportunity to meet with you as often as we have and to explore some of these issues behind the scenes.

I would like to ask you now to spend a few minutes discussing how the administration intends to implement the goals promised under the Uruguay Round to pursue the acceleration of tariff cuts for paper products and further tariff reductions for wood products.

Ambassador KANTOR. Under section 111 of the Uruguay Round Act, which passed this Congress, we have the authority, proclamation authority, to pursue that, and we are. In both of those specific products, as well as I indicated before, the Information Technology Agreement really is reduction in tariffs in those very important products as well, everything from computers to software and other high-tech products.

These are important areas. It is interesting to note in the paper area where we have reduced and we are going to zero, in paper, we have increased our exports by 30 percent in the first year of the Uruguay Round alone.

The reduction of tariffs and nontariff barriers makes a difference, regardless of macroeconomic factors, although they play on each other. So we will continue to pursue this vigorously.

Ambassador Lang and Ambassador Gardner, former Governor of your State, have done a marvelous job in working with our trading partners. We hope by the time we get to Singapore in December of this year that we have agreements not only on wood and paper, but other products as well.

Ms. DUNN. Good. Thank you.

I want to ask you a general question getting back to the sovereignty issue again that has been touched on in several different ways, and most recently by Congressman Shaw's question. Do you believe generally there exists the potential for loss of the U.S. sovereignty under the WTO?

Ambassador KANTOR. No.

Let me associate myself, which may be a little interesting to you, with the Heritage Foundation, the American Enterprise Institute, the American Bar Association, and Judge Bork, just to mention a few, who all believe that U.S. sovereignty was not in any way adversely affected by the Uruguay Round Agreements or the advent of the WTO.

Just to make a couple of comments about that, number one, for the first time since 1947, under the GATT, this was just practice, not codified. We have codified that the WTO, formerly the GATT, works by consensus. That is article IX in the first paragraph of article IX.

Number two, it is clear that we preserved our trade laws under this agreement.

Number three, it is also clear that no substantive right or obligation of the United States of America can be changed under this agreement without our consent.

Number four, no one, except the U.S. Congress or individual States and localities, can change U.S. laws and regulation without our consent. That is done by our elected officials.

Last, let me say this is a contract, not a treaty, as you know. The fact is that if we decided at any particular time, and I would hope this would never occur, but I will just say this, we can get out of this agreement with 6 months' notice.

So, in every way, we have protected our sovereignty, three administrations, two Republican and one Democrat, as we have tried to move forward to open up markets, get rid of unfair barriers, level the playingfield, yet protect our sovereignty.

I think we have reached the right balance, although we still have to make a lot of progress, but in terms of the sovereignty, I want to associate myself with those institutions and people I cited and indicate that I believe they are absolutely correct.

Ms. DUNN. Thank you, Mr. Ambassador.

Thank you, Mr. Chairman.

Chairman CRANE. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman.

Mr. Ambassador, I, too, want to commend you for your record and join the others. I see Mr. Rangel is here, and I wouldn't go quite as far as he did. Actually, I thought he was the most exciting figure in American politics today, but I really am pleased you are here with us and I want to join my colleagues in congratulating you.

Mr. Shaw asked a question about the procurement agreement and about the efforts that you have announced you will be undertaking with regard to other countries coming toward our level with the Foreign Corrupt Practices Act, and I am very interested to hear the comments you made about deductibility of payments by other countries. I am pleased we are pursuing that.

My specific question is, following up on Mr. Shaw's comments, What can we do as a Congress and what can the administration do to encourage other countries to join the procurement agreement? My understanding is that there are 20 countries that have signed to date, which seems to me to be inexcusably small, and how can we move countries toward that?

Ambassador KANTOR. Thank you, Mr. Portman.

I think it is a matter of emphasis and priorities. To the extent that we all work together, regardless of party or regardless of Congress or the executive branch, in our various meetings and our negotiations as we move WTO regionally or bilaterally to address these issues, the more impact we are going to have and the more success we are going to have.

It is clear that continuing pressure makes a difference. It is clear we have made great strides with Japan over the past 3 years because we have focussed on the sanctuary markets. We have reached 20 agreements, and we have tried to make sure the playingfield has become more level.

In 1995 we increased our exports to Japan almost 20 percent, at 19.45 percent, almost five times more than the level of imports from Japan increased. That is enormous progress.

Japan's trade deficit with the United States dropped in 1995, and Japan reported in January that they had the lowest trade surplus with the United States than any time in the last 12 years.

Continuing pressure, focus, discipline, and working together will make a real difference here.

Let me indicate just one other thing I didn't mention. There was a study done from May 1994 to April 1995 by the U.S. Government which indicates that we found 100 contracts where bribery and corruption were involved, involving $45 billion, which adversely affected U.S. interest. So we can see there is a huge problem that needs to be addressed, and we need to pay real attention to it.

Mr. PORTMAN. It strikes me this is an area where we can see real progress in leveling the playingfield, and I encourage the administration to let us know what we can do to help. I think the procurement area is the proper focus, to make it more transparent, and to encourage, again, other countries to come into an FCPA-type arrangement.

The second question has to do with the WTO, more generally. As is the case with many of my colleagues, I have heard a lot from my constituents about the sovereignty issue and other concerns of moving forward with this, and I would agree with Mr. Thomas. We didn't necessarily use the best name for the organization. It gave people some ammunition.

One thing I told my constituents consistently was that this was going to actually aid U.S. businesses and industries because of the binding nature of the WTO as compared to the previous GATT panels, and following on with Mr. Thomas' question and Mr. Gibbons' question, with regard to the question of bananas and the European Union. As you know, we have had two panels in the last 5 or 6 years, both of which found the Europeans in violation of international trading rules with regard to their banana regimes.

Both were blocked, and now we have this new WTO with its provisions, both with regard to allowing a dispute to go forward, so you don't have the delays, but also with regard to making a finding and not permitting one country or group of countries to block it.

I would just encourage you to move forward. I got a sense from your answer that there will be further discussions with all parties, but is your intention to proceed with WTO action in the next matter of weeks or in the next month if, in fact, those negotiations aren't successful?

Ambassador KANTOR. If our offer to sit down with the Eastern Caribbean countries, our Latin American colleagues, and the European Union is not taken up, not accepted, we will proceed as soon as possible. We have waited long enough. I think we have been quite patient, frankly.

We have got interim, as you know, agreements with Costa Rica and Colombia that the impact of their framework agreement with Europe has been lessened to a great extent, but we need to end this discrimination, while frankly protecting the preference and preference rights of Eastern Caribbean countries.

We all agree they should be protected. At the same time, we end the discrimination by the European Union against Latin American bananas.

Mr. PORTMAN. I encourage you to move aggressively on that. I think there is a way to take care of the ACP countries, and the Europeans could have done it a long time ago, had they had that interest, rather than protecting European companies. I think this is what it is all about.

Ambassador KANTOR. If we just went back, Mr. Portman, to the situation that existed prior to 404—that is the regulation in Europe that went into effect—that would be a solution that would work.

Prior to 404, for the Eastern Caribbean countries and African countries and the Canary Islands, Latin American banana exports were increasing, and our companies were not being discriminated against. That is what we need to go back to.

Mr. PORTMAN. I agree.

One final comment, just quickly, I agree with Mr. Gibbons.

Chairman CRANE. The gentleman, please, your time has expired.

Mr. PORTMAN. Thank you, Mr. Ambassador.

Ambassador KANTOR. Thank you, sir.

Chairman CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. I appreciate the chance to participate, and I would like to add my words of commendation to our distinguished Ambassador for your efforts. Statistics sometimes tell the truth.

We look forward to your appearance next month in Michigan to have a chance to talk about progress to date in autos and auto parts with Japan and the territory yet to cover.

Let me, if I might, say a quick word about fast track. You were asked that. I think that fast track might have a difficult time going through here under any circumstances, but its only hope, I would think, would be a fast track authority relative to Chile. It was essentially the same as fast track authority in previous negotiations. I continue to be mystified why there is an effort or why anybody would really try to change that.

I think, if anything, the last couple of years, we have learned that the relationship between so-called labor, it is really broader than that, and environmental conditions in another country can be very much related to the trade equation and its artificial to separate them.

We have a chance to look at any agreement that is negotiated by you, and to say yes or no. So I hope you will continue to advocate, as you are, but insist you have the same authority as your predecessor.

Let me ask you, if I might, about a case you are working on, to the extent you can comment, because I think it does reflect on the issue of sovereignty, for example, the continuing effect of section 301, and also, I think it manifests that while progress is made with Japan as indicated in the figures, we have a foot in the door. We have a considerable ways to go, and that is the Kodak case.

Could you, to the extent you can, comment on where that stands?

Ambassador KANTOR. The Kodak case involves allegations of discrimination in the Japanese market with regard to foreign competitive film and photographic paper; in this case, Kodak being the largest supplier of both in the world, having about 40 percent of the world market outside of Japan and only about 7 percent in Japan. The concerns we have, I think, are legitimate and of great importance.

There are two aspects to the discrimination we are looking at now. One, of course, is any competitive behavior. Fuji Film, which is the largest purveyor of film in Japan, has about 70 percent of

the market, if I am not mistaken. It works through wholesalers known as the Tokiokitin.

Because the film industry is such, when you sell small photograph shops, you need a wholesaler to do that, and you have a large sales force to do that; large film and photographic paper companies, foreign or domestic, could not do that and maintain that kind of sales force.

In Tokiokitin, there are four of them, and Japan, of course, does not carry foreign competitive film and photograph paper. They carry Fuji. In fact, the don't even carry Konika, which is, of course, a Japanese company as well.

There are also tie-ins between banks in Japan, Fuji, and the Tokiokitin as well, that has had adverse effect upon Kodak and upon other foreign competitive companies, Agfa being a German company.

In addition to that, there are various laws, including the large retail store law, which also have had an adverse effect upon Kodak's ability to sell their product which is so popular around the world in the Japanese market, the second-largest market in the world, and for this product, nearly the largest market in the world.

We have had this under investigation for a number of months. We have tried to implore our Japanese colleagues to negotiate with us over it. We have not been successful in achieving that negotiation.

Absent that, we are looking at what our alternatives might be.

If you would allow me at least at this point to be somewhat careful in how I might answer the last part, what we are prepared to do, we are prepared to operate in the best interest of American workers, our businesses, and fair rules, and if I could stop at that point, I think it might be appropriate.

Mr. LEVIN. Fine. Thank you.

Chairman CRANE. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Mr. Ambassador, I want to add my voice to those who have said good things about you today. You don't always hear good things, but those of us who are interested in the African trade question appreciate the response of your office to this Subcommittee.

As you know, Mr. Rangel, Mr. Crane, myself, and Mr. Gilman have formed a task force to look at this issue. We will try and respond to what you have done, but we appreciate your involvement.

I would like to ask a question, however, about the issue. It is peripheral, perhaps, to GATT, but it is directly related to GATT in some of our minds.

China is a major issue for this Congress, and we will face the China issue again in June. In linking the issues of human rights and trade—several years ago—we are now confronted with a whole series of problems with respect to China.

The Congress is going to struggle. Certainly, the House of Representatives is going to struggle with the issue of most favored nation in the face of military saber-rattling by China and issues about human rights and so forth.

It is my understanding at this point that Eximbank participation in China projects has been suspended, at least until, I think it is, March 23, because of arms issues. Is that right?

Ambassador KANTOR. Proliferation issues.

Mr. MCDERMOTT. Proliferation issues.

Ambassador KANTOR. Yes, sir.

Mr. MCDERMOTT. I would appreciate your telling the Subcommittee what you anticipate. You may not know which scenario, but if the Chinese do not respond, what are you expecting in the form of a response from them, just to bring us up to date as to what the issue is and how we should read what happens in the next several weeks?

I don't have to explain to you about the Eximbank. It is pretty important to many of us.

Ambassador KANTOR. To say that China is a difficult and challenging issue and complicated by recent events, would, I think, be the understatement of this morning.

There are a number of concerns we have with China at the present time. One only needs to pick up the morning paper to understand that.

In addition to the current concern over Taiwan, of course, are concerns of proliferation, which you have indicated. We have raised concerns with the United Nations Human Rights Commission on human rights, and of course, we have concerns in trade over the implementation of the intellectual property rights agreement we reached and signed on March 12, 1995, where we are right at the 1 year, the first annual review.

Second, on market access, we continue to have concerns regarding agricultural products, and the ability of U.S. service industries to locate there, especially insurance, financial services, and value-added telecom.

Last, but certainly not least, are our continuing discussions with China over their desire to accede to the World Trade Organization.

There is no more important bilateral relationship in the world that the United States has than our relations with China. We believe in full and constructive engagement. That is the only way we are going to make progress in each of these areas with China.

On the other hand, we have to insist that China live up to its agreements; that they share with us a commitment to peace, stability, and economic growth in the region, and we continue to work not only on a bilateral basis, but certainly on a regional and multilateral basis as well.

This is going to be a great challenge for all of us in Congress, both sides of the aisle, as well as in the administration to try to march forward to ensure that China operates in a way that is productive in terms of peace, stability, and growth, and also to make sure we make no unfortunate missteps as we do that.

Mr. MCDERMOTT. What kind of response are you actually expecting or requesting from the Chinese to release the suspension of the Eximbank?

Ambassador KANTOR. Obviously, that is a State Department issue, and they have jurisdiction over that. I think it would not be wise for me to address that issue.

Mr. MCDERMOTT. I appreciate that. I didn't mean to question you on something that you were not prepared for. That is why I said it is a little bit off the subject, but I think it is an issue we are very concerned about, and I hope the Chairman may at some point

get the State Department to come, so that we can have some discussions with them about this issue.

Chairman CRANE. Thank you very much, Mr. McDermott. I appreciate it.

Let us express deep appreciation to you, Ambassador Kantor, for enduring and, second, compliment you for the job you have done and will continue to do. We look forward to working with you on a continuing bipartisan basis on our mutually beneficial trade interest.

Now we are about to recess the Subcommittee until 1:30.

Ambassador KANTOR. If I might, Mr. Chairman, may I just thank you not only for your courtesy today, but also moving forward the shipbuilding agreement. I know a markup is scheduled next week, but thank you for that. It is an important agreement, and I appreciate your moving forward.

Chairman CRANE. Well, thank you, very kindly.

Ambassador Yeutter is the next to appear before the Subcommittee, and we had originally contemplated having him deliver testimony first and then we would get to the questions and answers at 1:30, but I think since a number of colleagues would prefer to have continuity between the testimony Ambassador Yeutter will make and the question and answer period to follow, he has been gracious enough to agree to come here at 1:30, and we will do it all at that time.

So, with that, the Subcommittee stands in recess until 1:30.

[Whereupon, at 12 noon, the Subcommittee recessed, to reconvene at 1:30 p.m., the same day.]

Chairman CRANE. It is a distinct pleasure and honor on my part to welcome an old and dear friend, a man who served with distinction in the public sector and is back serving with distinction in the private sector, but who also served as our U.S. Trade Representative.

I don't know whether we call you "Ambassador" or "Mr. Secretary," because you were Secretary of Agriculture as well.

Clayton has a perspective, perhaps, that transcends that of any of us with regard to Uruguay Round negotiations. They proceeded during the administrations of three Presidents, but you were there at the inception at Punta del Este in 1986. So you bring unique insights to the Subcommittee. We welcome you here to hear your testimony, Mr. Ambassador. We will call you "Ambassador," since you as Secretary testified before other Committees than this one, and we would like to hear your testimony at this point.

STATEMENT OF HON. CLAYTON K. YEUTTER, OF COUNSEL, HOGAN & HARTSON, L.L.P.; FORMER U.S. TRADE REPRESENTATIVE; AND FORMER SECRETARY, U.S. DEPARTMENT OF AGRICULTURE

Mr. YEUTTER. Thanks very much, Mr. Chairman. It is a delight to be here, great to see Congressman Gibbons as well. Both of you bring back lots of memories, as does this room itself. It doesn't seem like it has been 10 years since we launched the Uruguay Round in Punta del Este, but it has been, and lots of things have happened on the trade front since then, as both of you well know.

I prepared comprehensive testimony for this hearing, Mr. Chairman, as you may know by now. So that is certainly free for distribution as you wish. I will, of course, shorten it tremendously in my oral presentation.

Chairman CRANE. Your full testimony will be inserted in the record.

Mr. YEUTTER. Thank you.

One reason I mentioned that was because I said some very complimentary things about you, Congressman Gibbons, in that prepared text. I wanted to make sure everybody knew that.

Mr. GIBBONS. Thank you.

Mr. YEUTTER. Congressman Gibbons, you have been one of the real powers of the movement toward free and open trade for a lot of years, and as you leave this Congress, you deserve a gigantic pat on the back.

To get to the subject at hand, Mr. Chairman, I commend you for holding these hearings. Now that we are 10 years past the launch and 1 year after the Uruguay Round Agreement went into effect, there clearly is a need for oversight to determine where we are heading and why we are heading there.

It is also timely because this happens to be a Presidential election year. As you know, at such times—we went through the same in 1992 and 1988 and probably every other year back to the thirties—we are subjected to a lot of exaggerated views on the trade front, a lot of demagoguery. Somebody must attempt to neutralize that, offset it as best we can, so we don't lose our balance as we make policy decisions on the trade front in 1996 and beyond.

As you well know, from the activities of recent weeks, there are a lot of job insecurities out there today, even though the economy has been performing relatively well. Those insecurities are legitimate because this is a very fast-moving world, it is a high-tech world, and that frightens lots of people.

The answer to fear, even legitimate fear on the part of the workers of this country, is not the creation of more fear. We have heard a lot of rhetoric recently that simply exacerbates the situation, rather than ameliorating it. We need to get beyond describing the problems, the issues, and the challenges, and get on with articulating what it is we ought to be doing to alleviate some of those fears.

That is the subject for another hearing, not for this one, but it is the context in which you hold the hearing today.

Closing borders is certainly not the way to respond to this challenge. That is economic fear at its zenith, and there is no reason for that in the United States today. Closing our borders would imply we have a massive economic inferiority complex, and as I will shortly suggest, there is no reason for this country to have an inferiority complex of any kind.

To put that in historic perspective, Mr. Chairman, I can remember when I first appeared before this Subcommittee back in early 1986. If there was a time in this country's history when we might legitimately have had some concern about our international competitiveness and whether or not we ought to have an inferiority complex, that was probably it.

As you both will remember, we had a gigantic trade deficit then, one that seemed to be skyrocketing out of control. We had a dollar

that was totally out of balance in the international currency markets, inflation sky high, interest rates sky high. It was not a happy economic scene.

So it would have been easy for all of us, those of us in the executive branch and those of you in the Congress at that time, to turn in a protectionist direction. There was certainly lots of motivation then—in my view, far more than there is today—but we chose not to do that. That was a bipartisan decision, one involving both the executive and legislative branches of government, and it was the correct decision.

What has happened in the intervening decade is persuasive evidence that we all made the correct decision at that time.

I believed in 1986 that we could compete, and observing what has occurred in the past 10 years, I can assert today that we can compete exceptionally well in the world in 1996.

As both of you know, I sit on a number of corporate boards involving a number of different industries in this country. So I am probably as close to the overall real world economic scene as anyone. Consequently, I can attest from experience and personal knowledge that we as a nation are just enormously competitive today.

Let me return briefly to what has happened in those 10 years in terms of both a government response and a private sector response to the challenges we had a decade ago. First of all, we responded by having a much more aggressive trade policy. That began in about 1986. It has continued in all the intervening years since, with Ambassador Hills and Ambassador Kantor, and that has certainly paid major dividends for this Nation through the years.

We have done that multilaterally and bilaterally, and today we are seeing the benefits of many of those often contentious negotiating efforts over the last decade.

As Ambassador Kantor indicated this morning, U.S. exports are at an all-time high today, $575 billion in 1995, and at least some of that success is attributable to our trade negotiating efforts, going all the way back to the mideighties. Indeed, more of it is attributable to those earlier negotiations than to the ones in recent years because there is a lag time before the benefits of negotiating efforts are felt.

So we have the self-satisfaction, those of us who were working on these challenges back in the mid and late eighties, of seeing the fruits of our efforts here in the mid to late nineties. Ambassador Kantor will see the fruits of many of his efforts 5 or 10 years hence, and all indications are those will prove to be very worthwhile endeavors as well.

I wanted also to say that in addition to the government doing its part, meaning both the executive and legislative branches, the private sector did its part, too. You will all remember in the mideighties when journalists were writing articles about the hollowing out of America, the destruction of our manufacturing/industrial base, the loss of jobs, and the likelihood that we were all going to be hamburger flippers and so on. Those predictions turned out to be fallacious, and one of the reasons they did was because the private sector of this country weighed in. Survival was at stake for a lot of American firms, and they did the right things. They

brought their costs down in a dramatic fashion, and they made solid executive decisions in turning around their own situations, over and above anything we did for them in the public sector.

As a consequence, our private sector is just immensely competitive today. I would give one example of a company on whose board I sit. That is Texas Instruments, a company that many of you know well, one of our outstanding firms in the high-tech industries.

In 1994 and in 1995 and coming up again in 1996, for 3 consecutive years Texas Instruments will have improved the productivity of its plants sufficiently that it will have saved the cost of a new wafer plant each of those 3 years. When you consider a new semiconductor wafer plant costs in the vicinity of $1 billion, that means this company has made approximately $1 billion of productivity improvements 3 years in a row.

That just exemplifies what the American private sector has been doing and why there is no reason to fear international competition. People can talk all they wish about dollar-per-hour labor or something even less than that in China, but that is not what will determine our international competitiveness. It is the package of all of the factors of production.

When you look at what American firms have done with capital investments and sheer good management, adding to their own infrastructures, benefiting from the infrastructure that the Nation as a whole has created for them, you have to be exceedingly proud of what they have done over the last decade. That is why we should not be fearful, and it is why we should get over this economic inferiority complex that seems to be plaguing some of us—at least some of us in the political realm.

Now, let me focus on the Uruguay Round itself. It may be worthwhile to recall what it was we sought to achieve in the Uruguay Round and what finally did happen.

As you remember, we went to Punta del Este in 1986 with five major objectives over and above the traditional negotiating objectives we have had at all GATT rounds. Those were agriculture, intellectual property, services, investment, and what we called GATT reform.

We were successful, as you will recall, in getting all five of those topics on the Uruguay Round agenda. Regrettably, it took a lot longer to negotiate the Round than we had hoped, for we then anticipated finishing the Uruguay Round in 4 years and it took about twice that.

The ultimate outcome, in my view, is really quite satisfactory. It isn't perfect, of course. No negotiation is perfect, and one involving 100-plus countries is inevitably going to be very difficult, but we should never compare it to Utopia in the trade negotiating arena. We should always compare it to the status quo, to what the situation would have been had the Round not been completed.

When one compares the work product that he emanated from the Uruguay Round with the status quo of 10 years ago or, for that matter, with our economic status a couple of years ago when the Round came to this Congress for approval, there is no comparison.

The Uruguay Round will place this Nation and the world in a far better situation in terms of the trade policy principles and the potential for creating jobs than if we had not had the Round.

As you will recall, we ended up with substantial reforms in agriculture for the first time ever. We had barely been able to get agriculture on the agenda of earlier rounds of trade negotiations.

As Ambassador Kantor indicated this morning, we now have an intellectual property code, though it is still relatively cryptic at this stage, and we will need embellishment and expansion over time. But it is far better than having no code at all. Tackling intellectual property disputes on a bilateral basis would be a very costly and time-consuming proposition.

About the same can be said for services, where we had nothing in the GATT before. At least now we have something on which to build.

The same thing with investment, a subject that had had very little discussion prior to Punta del Este. We finally got at least some curbs on export performance and domestic contact requirements, and those are important.

In GATT reform we wanted to get a handle on the dispute settlement process and shape it up because it had been working to our disadvantage. We had been winning GATT cases and having the results vetoed by the losing nation.

That has since stimulated a sovereignty argument, and apparently you had a lot of questions this morning, Mr. Chairman, about infringements on sovereignty. In my view, that is a totally nonsensical argument.

This whole debate over sovereignty is pointless because, in a sense, we have "infringed," putting the word "infringed" in quotes, on our sovereignty every time we have an international agreement of any kind, in trade or anything else. So it all depends on how one defines sovereignty, but the fact is we don't do agreements internationally unless we feel they are in the best interest of the country. So, if there is any infringement on sovereignty, we consider that to be worthwhile because of the benefits we get from "infringing" on somebody else's sovereignty in the process.

If one evaluates dispute settlement in that light, Mr. Chairman, one must to come to the conclusion that if we win more GATT cases than we lose, and we always have, and if we win more WTO cases in the future than we lose, and in my view, we always will, then an improved dispute settlement mechanism is clearly in the self-interest of the United States. That ought to put the sovereignty issue to rest.

The final outcome is one of which we can all be proud. There is a lot of work yet to do in the World Trade Organization, but that will always be the case. One has to evaluate the achievements of each negotiation, and the Uruguay Round was a major negotiation which had major achievements.

I wish we hadn't changed the name from GATT to WTO. I believe you had a little discussion on that this morning, too. When it happened, I sighed because I could see the debate coming, and it just wasn't worth it. Had the name not been changed, probably 75 percent of the demagogic discussion that you have had over the past year or so would have disappeared, but such is life; we can't go back and correct that.

There is a sound basis for calling this trade organization the WTO, but we ought to make sure the people of this country know

the World Trade Organization is not some one-world, Third World-dominated, U.N.-type organization in which the United States is going to be jerked around and consistently outvoted. The GATT has never worked that way. The World Trade Organization is not going to work that way either.

We don't have time to talk about the challenges that are ahead, but I wanted to leave you with a couple of thoughts on that point.

One is that, as is always the case, the major players are going to have to lead if the WTO is going to succeed, and that fundamentally means the United States, Japan, and the European Union.

In my judgment, the major players have not provided as much leadership over the last year or so as they should have. They have been wrapped up in other things, in our case in a lot of discussion of free trade arrangements in Latin America and Asia. Those are laudable and legitimate objectives, but we have to prioritize, and it seems to me this Nation needs to get the WTO at the top of its priority scale. If it doesn't function well and if we don't make sure it functions well, we are going to pay the price in the future.

If we have a weak or stifled WTO, what we are doing in these other areas will be much less meaningful. Regional free trade agreements must all fit within the World Trade Organization. If they don't fit and fit well, and we don't have the umbrella of a strong and effective WTO, the whole system could collapse on us.

The second point I wanted to make, which is more specific, relates to Asia, and specifically to China.

I believe, Mr. Chairman, one of the mistakes we have made in the last few years is we have devoted far too little time to the issue of helping China become a responsible world citizen in trade and in every other respect.

We have needed a carefully thought-out strategy for nurturing China's participation in the world economy, fostering its entrance into the World Trade Organization on the right terms, and simply teaching China it cannot be a renegade in trade, national security, or foreign policy terms.

In my personal view, we have spent far too much time dealing with Japanese issues, in particular, and with a number of other issues that constitute the trade battles of the eighties, rather than dealing with the trade battles of the nineties and the beginning of the next century. We have spent far too little time developing strategies where the issues really count today, with China being foremost on that list.

Finally, Mr. Chairman, to return once more to the whole question of job creation and job uncertainties that prevail today, there is no way, Mr. Chairman, for us to respond other than to position this Nation where we produce high-quality goods and services at an attractive price and then market them aggressively all over the world. That is the only answer. It ought to be the guidance for your oversight hearings on the World Trade Organization, NAFTA, and everything else, and that ought to be the political guidance for the Presidential candidates of 1996.

That suggests the need for free and open trade, not closed trade. If we are as competitive as I know we are, then the Uruguay Round points us in the right direction, and we need simply to build

on that foundation and move toward free and open trade around the world.

Now, there has to be fairness imposed in that process as well, and that is where the Uruguay Round and the WTO also come in. If there are to be rules of conduct in international trade, they have to be provided on a multilateral basis, and only the WTO can carry out that task.

So, I encourage you in what you are doing, Mr. Chairman. I believe we are off to a good start with the World Trade Organization, and the challenge now is to make sure the United States leads, both from the legislative branch and the executive branch of government.

[The prepared statement follows:]

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STATEMENT OF AMBASSADOR CLAYTON K. YEUTTER[1/]
BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON TRADE

Mr. Chairman, Members of the Committee, it is an honor to appear before you today. It was my privilege to work closely with this Committee to implement and execute U.S. trade policy as President Reagan's U.S. Trade Representative and as President Bush's Secretary of Agriculture. The far-reaching trade initiatives launched by the Reagan and Bush Administrations to open markets, challenge unfair trade barriers to American exports, and strengthen the global trading system could not have been undertaken without strong bipartisan support from this Committee.

A Tribute to Sam Gibbons

Last week, Congressman Sam Gibbons announced his retirement after 34 years of distinguished service in the House of Representatives. I would like to pay special tribute to Congressman Gibbons today. Those of us who have worked with him know that he has always brought strong convictions and firm principles to America's trade policy. In Congress, he has consistently supported an open global trading system and expanded exports, regardless of the political winds. The Uruguay Round might not have occurred without his leadership and unswerving commitment to free trade. It is only fitting that, after having worked for over a decade to launch a new round of GATT negotiations and to bring it to a successful conclusion, he chaired the Ways and Means Committee during the historic drafting and approval of the Uruguay Round Agreements Act.

A Historical Perspective

Mr. Chairman, America stands today on the verge of a new century, one which holds unparalleled promise. America's economic destiny and the jobs of tens of millions of American working men and women will become even more closely tied to developments outside our borders.

1/ Ambassador Yeutter served as U.S. Trade Representative under President Reagan and as U.S. Secretary of Agriculture under President Bush. He is Of Counsel at Hogan & Hartson, L.L.P.

The Nebraska where I grew up was a smaller place. Our country school teachers made sure we followed events in Europe and Asia, but we glimpsed these places primarily in our imaginations and through radio broadcasts, books, and newspapers.

My first study of geography was by kerosene lamp. Shortly thereafter, I saw young Nebraskans, many barely graduated from high school or college, leave to fight on the battlefields of Europe and the Pacific. Some never came back; others returned grievously wounded. Any American who has looked upon the rows of white crosses in the American cemetery in Normandy must feel deep emotion for the courage, patriotism, and sacrifice of a generation of young Americans.

The lesson of World War II is clear. America's security and prosperity depend on being engaged with the world. We cannot put up tariff walls to shut out foreign trade without inviting economic hardship and widespread unemployment at home. And America must lead. Of the nations of the world, we alone had the capacity, resources, and commitment to stand firm against Nazi and Soviet expansionism and to fight, and win, the Cold War. And we alone have the capacity to lead today.

In the post-World War II period, the American people did not retreat into isolationism. Instead, American statesmen created an enduring international economic architecture in the IMF, World Bank, and GATT. Our leaders saw the expansion of international trade as a vehicle for America's prosperity and understood that trade and investment are instruments for discouraging armed conflict and for promoting freedom and democracy.

Those views have been vindicated time and again.

-- America is the world's largest exporter, well ahead of Japan and Germany. Our merchandise exports have surged to over $500 billion annually, boosted by rapidly expanding global demand for American information and telecommunications technologies.

-- Exports of U.S. goods and services support over 10 million American jobs. Because our exports are dominated by high-technology, capital equipment, and other advanced products, export-related jobs demand higher skills and pay higher wages than the average U.S. job -- about 17 percent more.

-- Trade -- imports and exports -- now accounts for over one-quarter of U.S. GDP, double what it was in 1960.

-- U.S. subsidiaries of foreign companies now account for over 4.7 million American jobs -- about 5 percent of our total work force.

A New Century – Open Trade? Or Closed Borders?

At a time when millions of American jobs rest on open trade, the costs of a protectionist trade strategy are unthinkable. It is all the more astounding that any politician would propose to raise a white flag when America's economic prospects are so bright. We are about to reap the benefits of a decade of restructuring by American corporations and of President Reagan's fundamental attack on high taxes and excessive government regulations. In the last decade, American corporations have transformed themselves into the leanest and meanest competitors in the global marketplace. They have slashed costs, improved quality, and accepted the relentless commitment required of any company that aspires to international leadership. Twenty years ago, many American companies feared the challenge of going head-to-head with European and Japanese rivals and sought refuge instead in antidumping duties, escape clause investigations, and quota legislation. Today, it is Europe and Japan who fear us.

If we put up protectionist barriers, our trading partners will reciprocate by closing their markets to America's leading exports -- aircraft, feedgrains, chemicals, computers, telecommunications equipment, power generation technology, meat, films, and popular entertainment. Pulling back from the global economy would be devastating for our farms and factories and for millions of American households.

These simple realities should guide our posture toward the WTO. America is part of the global economy. We cannot retreat without sacrificing our future. This means that our strategy should be to continue working to strengthen the multilateral trading system, to pursue market-opening agreements with like-minded countries, and to aggressively challenge foreign trade barriers under Section 301.

1986 – Launching the Uruguay Round

Mr. Chairman, nearly a decade has passed since the United States and more than 100 other nations launched the Uruguay Round of trade negotiations in September 1986. You and other members of the Ways and Means Committee will remember well the tense, contentious stages of that Punta del Este launching, as well as all the other Uruguay Round battles that took place over the next several years. You'll also recall the many occasions when the United States stood virtually alone as a proponent of free and open trade conducted under sound and sensible international rules.

Nearly a year has now passed since the Uruguay Round agreement went into effect, so an assessment of the initial phases of its implementation is certainly in order.

Was U.S. participation in the Round a mistake? Would we be better off as a nation if we were exporting and importing under the GATT rules that existed in 1986? The answer is a clear and unequivocal "no." To reach that conclusion, one needs only to re-examine our basic negotiating objectives in Punta del Este and see what has happened since.

As you will recall, the GATT itself came into being in 1947, in the aftermath of World War II. During the ensuing four decades, a number of multilateral negotiating "rounds" were conducted, always with the objective of reducing trade barriers between and among the participating Member nations. Those early negotiations dealt primarily with tariff levels, but eventually the agenda was broadened to encompass government procurement issues, subsidy disciplines, non-tariff barriers, antidumping rules, and a few other matters. By almost any tangible measurement, those rounds were a success; tariff levels were progressively reduced, other trade distortions were at least partially curbed, and trade volumes rose dramatically. The whole world benefited enormously from the synergies that evolved, the economies of scale and other productivity improvements that emerged, and the enhanced quality of life that millions of people were privileged to enjoy.

The United States was one of the major beneficiaries of a more free and open global marketplace, even though trade has traditionally constituted a smaller percentage of GNP in the U.S. than in most other countries. In 1986 we could readily see that trade was the answer to a lot of the world's economic problems, and we were frustrated that the potential was not being fully realized. In the U.S. we had the largest merchandise trade deficit in our history, and we felt that a large part of that deficit was attributable to the unfair trade practices of other nations. Many of those practices were, in our view, inadequately disciplined by the GATT, and some were not even covered by GATT rules. We were also dismayed by the ineffectiveness of the GATT dispute settlement mechanism; the U.S. was winning most of its unfair trade practice cases, only to have the losing country block the GATT working party reports in our favor.

As we prepared for the Punta del Este meeting, we concluded it was time for a quantum leap forward! The U.S. position was that we and other Member nations ought to "push the GATT envelope" a long way! Otherwise, the GATT as an institution would become increasingly irrelevant to the challenges and opportunities of international commerce. And we as a nation ran the risk of losing out on the export expansion/job creation opportunities inherent in a more open trading system.

U.S. Objectives

So we pushed, and pushed hard, for the addition of a whole host of subjects to the GATT negotiating agenda. Our Punta del Este "wish list" included:

1. Agricultural Trade Reform - an area of intense interest to us because of the productivity of American farmers and because agriculture was and still is our largest single industry. We had unsuccessfully sought to negotiate on this subject in past rounds, and we'd been continually frustrated in bilateral negotiations with other countries, particularly the European Community and Japan.

2. Intellectual Property Protection - a new subject for the GATT, but one of great importance to the U.S. since we have far more intellectual property (patents, copyrights, and trademarks) to protect than anyone. IP piracy was rampant in many parts of the world in 1986, costing U.S. firms billions of dollars annually.

3. GATT Reforms - Here we simply wanted to prepare the GATT for the next century, so that it would be in a position to foster international trade rather than hamper it. And, we wanted to overhaul the dispute settlement mechanism so that it would be responsive (some GATT disputes had been around for more than a decade) and effective (*i.e.*, we wanted to get rid of the "losing party veto" provision).

4. Services - another new subject for the GATT, even though services were by then a bigger part of GNP than manufacturing in many Member nations (including the U.S.). We saw services as having huge export potential for the U.S., particularly in high technology areas such as telecommunications and information processing. Hence, we felt it imperative that the GATT establish rules of conduct in this area generally comparable to those already in place for goods. Otherwise we'd be fighting the same market access battles on services in the coming years that we'd fought on goods for the past four decades.

5. Investment - still another new subject for the GATT, and one which had provoked little prior discussion. But it was important to the U.S., for investment and exports go hand in hand. With many products and services, we simply cannot do a first class job of marketing in foreign countries unless we invest where our customers are. In some cases the need is for production in that country; in others, the need is to have marketing and maintenance capabilities close at hand. If one cannot effectively service customers, the business will soon disappear. In particular we wanted to deal with "export performance" and "domestic content" requirements, both of which grossly distort business decisions by American firms.

The Final Uruguay Round Outcome

The U.S. was successful in getting all of the above topics on the Uruguay Round negotiating agenda, and in my view the final agreement made substantial progress on each of them. In agriculture, we have export subsidy disciplines in place for the first time ever, and those disciplines will become increasingly demanding over the six-year life of the Agreement. The Uruguay Round also provided at least some additional discipline on production subsidies, some market access (e.g., a first time opening of the Japanese rice market), and a sanitary/phytosanitary code that will begin to cope with food safety regulations being used as non-tariff barriers.

The Agreement also provides for a second tranche of agricultural negotiations to begin a year or so before the present tranche is fully implemented. If that negotiation builds successfully on the Uruguay Round format, the world should have something close to a free and open trading system in agriculture early in the next century. Our farm and food exports are today at an all-time high, due to the tremendous productivity of American farmers and food processors, and to market opportunities provided in these negotiations and in some of our earlier bilateral efforts. Every indicator suggests that our exports of agricultural and food products will continue to rise in the future, and that our already positive balance of trade in such products will continue to widen.

In intellectual property we now have an agreement on Trade-Related Intellectual Property Rights (TRIPS) on which to build. We'll undoubtedly need to fight these battles bilaterally too, as we have in the past, but being able to do battle multilaterally is a big advantage. It is time consuming and costly to engage country by country in intellectual property disputes (or any other issues, for that matter); it is a lot easier to be able to deal with more than 100 countries simultaneously (the WTO membership) on the issues that are covered by the Uruguay Round code.

The same argument applies to services. I wish that more progress could have been made on services in the Uruguay Round, but at least the fundamentals are in place. One must start somewhere, and prior to the Uruguay Round our services industry had no protection of any kind in the GATT. We now have a beginning, and we must build on it through future WTO negotiations.

In GATT Reform, the Uruguay Round provides a surveillance mechanism under which the trade policies of Member nations are periodically scrutinized. That will provide at least some incentive for nations to continue to move toward a more open trading system, rather than regress toward protectionism. Most importantly, the WTO dispute settlement provisions are dramatically improved. The loser country veto has now been eliminated, which means we finally can bring disputes to a definitive conclusion. That conclusion will be reached within a year, a gigantic improvement over past practice.

Some have suggested that these changes in dispute settlement constitute a surrender of our national sovereignty. That is just nonsense. The sovereignty argument is pointless, for every trade agreement we've signed over the past 200 years has in some way infringed on our sovereignty.

If we wish to remain "pure" from a sovereignty standpoint, we should never sign an international agreement with anyone, on any topic. In most, if not all, such agreements, we do something as a nation that we might not otherwise wish to do, or we refrain from doing something that we might otherwise have the right to do. Those are "infringements" on our sovereignty. But we accept them because another nation (or nations), at our behest, agrees to do something it might not otherwise wish to do, or refrains from doing something it would otherwise have the right to do. When that tradeoff becomes attractive to both parties, an agreement is struck. Such is the case with trade agreements, foreign policy agreements, environmental agreements, national security agreements, and a myriad of others. That's what international negotiations are all about. The United States will gain more than any other nation from a workable WTO dispute settlement mechanism. To suggest we've been victimized in this area is completely fallacious.

There were significant Uruguay Round achievements in the more traditional negotiating areas as well, including an overall average tariff reduction of more than 30 percent.

No negotiation is ever fully satisfactory, and the Uruguay Round had its disappointments too. But all in all, for those who believe in the principle of comparative advantage, and therefore in the merits of open trade, the Uruguay Round was a major success. It was the most comprehensive trade negotiation the world had ever experienced, and the final Agreement was broad, deep, and well balanced. It will unquestionably foster the expansion of world trade during the remainder of this decade and well beyond.

Critiques – and Their Credibility

From a parochial (U.S.) standpoint, I do regret that the name of the secretariat was changed from GATT to WTO. There were good reasons for making that change, for the World Trade Organization better reflects the scope of the Uruguay Round agreements and the future challenges of implementing them. Nevertheless, the new name and its acronym created fears in the minds of many Americans that this was some new, one world, United Nations type organization in which the U.S. would be mercilessly jerked around and ultimately outvoted by a consortia of other nations. Those fears are groundless, for the basic *modus operandi* of the WTO will change little from that of the GATT.

The GATT has always been a forum for meaningful real world trade negotiations. That these negotiations have economic consequences has given them a seriousness and pragmatism lacking in other international organizations, where the principal currency consists instead of stale ideology, verbose speeches, and meaningless resolutions. Because the GATT has an economic focus, the major players -- particularly the U.S., European Union, and Japan -- have always had a disproportionate influence. U.S. negotiators have never had a major tantrum over the way the GATT has functioned during its half century of life. On balance, it has been a huge positive for the United States. Dispute settlement has been a frustration for us, but that process will function more effectively under the WTO than under the GATT. (In addition, if the Congress were to pass S. 16, sponsored by Sen. Dole, we'll have a mechanism for reviewing and critiquing decisions that go against us.)

Finally, there is nothing in the WTO that precludes the effective and aggressive use of Section 301. While some have sought to excuse U.S. Government inaction under Section 301 by blaming the WTO, the reality is that foreign governments have always been free to respond in kind when the United States imposes sanctions under Section 301. This was true under GATT; it is true now under the WTO. Thus, aggressive implementation of Section 301 has been, and continues to be, a function of our political will to stand up to foreign trade barriers. I do not find it constrained by the WTO.

American Competitiveness

Mr. Chairman, some have suggested recently that the U.S. ought to abandon the WTO, protect its market from the competition of low wage countries, and thereby preserve the jobs we now have. There is a populist appeal to that proposal, for many Americans feel insecure today about their jobs.

We've always had winners and losers in our capitalist society, and the vast majority of Americans want it no other way. We're a nation of risk-takers; that is what has separated us from the rest of the world, giving America its unique greatness.

Nevertheless, the world moves faster today than previously, and dynamic economies quickly reflect the need for change. That dynamism, advantageous in so many respects, may be separating firms into the winner and loser categories more rapidly than before.

There is also much more capitalism in the rest of the world than there was a decade or two ago, and that creates competition. We must decide whether we wish to confront that competition head on, or whether we'd rather close our borders and hope the competition will quietly go away.

The latter course makes no sense unless we truly believe we can no longer compete. In the early years of the GATT, we led the world in competitiveness by a wide margin. Then, for many reasons, we gradually lost our relative competitiveness. Our productivity improved at a very slow pace, whereas some of our competitors made great leaps forward. By the early 1980s we discovered, to our chagrin, that we were no longer miles ahead of the competition. Japan, Germany, and a number of other countries had leap-frogged us in many product and service areas. Journalists began to write about the "hollowing out of America" and the potential demise of our manufacturing industries, and many Americans concluded that our best days were behind us.

Were those circumstances extant today, one could build at least a plausible argument for closing our borders, moving in the opposite direction from the thrust of the Uruguay Round. Doing so would be a losing proposition in the long run, but it would appeal in the short run to some segments of our economy.

But those are <u>not</u> today's circumstances. Thanks to what we did as a nation (and particularly in the private sector) in the '80s, the outlook for the '90s and beyond is far brighter. There is no reason for the US. to have an economic inferiority complex today. On the contrary, we're number one in the world again as a consequence of major productivity improvements over the past decade or so. And we're better marketers too. The U.S. is now the envy of countries that only a few years ago prematurely relegated us to the scrap heap of defeated competitors!

We need not fear $1 per hour (or lower) labor in some competitor nations. Labor cost is only one of several determinants of the final competitiveness of a product or service. Technology, executive management, capital, labor skills, and infrastructure all play a part. It is the total package of factors of production that determines competitiveness, rather than a single factor. And we're in front of most everyone in the world in most everything when total packages are compared.

Conclusion

In choosing to compete, we've made the correct decision. That's the American way, and we've succeeded over and over again for 200 years when we've put heart and soul into meeting such a challenge. There is no reason to believe we cannot succeed in the realm of international trade and investment. If the WTO does its job well, the rules of the game will be as fair as one can reasonably expect, and we'll win or lose on our merits. As Americans we ought to feel good about being dealt a hand with that much appeal. If we cannot play it in a way that will expand exports and create jobs, we'll have only ourselves to blame. That is the challenge and the opportunity of the Uruguay Round; and that is what the WTO is all about.

All in all, the Uruguay Round has given American firms a much improved environment in which to conduct business. Trade is growing by leaps and bounds, and it has finally entered the lexicon of thousands of U.S. firms. It is by far the best antidote we have for the job fears that prevail today.

The Uruguay Round is on its way to becoming one of the world's crowning economic achievements of the latter part of the 20th century. American history books will grant it that status if we can avoid the temptation of torpedoing it during election years!

Mr. Chairman, I would be pleased to answer any questions you and other members of the committee may have.

Chairman CRANE. Thank you very much for your testimony.

In what areas do you think we have the best opportunity to make concrete progress in the upcoming Singapore Ministerial in December?

I might add something to that. What issues do you think will be the most difficult to resolve?

Mr. YEUTTER. As you know, the Singapore agenda is not yet fully finalized, Mr. Chairman, but without question, there is plenty for the WTO to do. I would tick off a few issues.

First of all, obviously, the WTO needs to deal with leftover issues from the Uruguay Round. There are a whole host of matters that didn't get fully finalized. Financial services is one where the United States has a big stake. Telecommunications is another. Services, generally over and above financial, have a lot of open questions yet.

Probably the biggest of all is subsidy disciplines. In my view, the Uruguay Round did not accomplish nearly as much as it should have in subsidy disciplines. That is still a huge problem for the world, and my biggest single disappointment in the outcome of the Uruguay Round. There are a lot of zero-for-zero tariff possibilities that could still be explored that we didn't wrap up in the Uruguay Round. Government procurement and the issue that Ambassador Kantor surfaced this morning—bribery and corruption—could also be on the agenda. I am sure I am missing some.

The OECD, of course, is working on an investment code which, hopefully, will be brought to the World Trade Organization reasonably soon. That deserves attention as well.

Chairman CRANE. One of the issues I am sure all of us have been confronted with on the campaign trails especially is the loss of U.S. influence under this expanded World Trade Organization. Could you address that question?

Mr. YEUTTER. I don't really believe we have lost any influence.

It doesn't bother me at all that there are 100-plus countries in the World Trade Organization. I happen to think that is healthy. The more we can bring under the umbrella and the more we can force to abide by sensible international rules the better. If countries are outside the umbrella, they can operate under any rules they wish, except we can counter them through section 301. Doing so in that manner is not efficient, so giving them discipline in the World Trade Organization is really a very good thing. The more countries that will be disciplined by the rules of international trade the better.

In terms of our influence dissipating just by the force of numbers, Mr. Chairman, there are always a handful of countries that carry by far the most influence in any international organization. From that standpoint, it makes little difference whether there are 75 countries, 100, or 125 in the World Trade Organization.

The major participants in international trade are always going to have the most clout. We simply need to make sure we assert that clout and use it in an effective and beneficial way.

Chairman CRANE. I am sure you have seen the figures that for every billion in exports, that translates roughly into 20,000 new jobs here at home, but perhaps even more importantly, those jobs pay almost 20 percent higher on average than the jobs that are related almost exclusively to the domestic economy.

Could you comment just a little bit on that? It is a point that is hard, really, to get disseminated.

Mr. YEUTTER. It is a very difficult point to articulate because a lot of folks simply don't connect jobs and exports.

They rarely see the product going directly into an export market. When it leaves the plant, they don't know whether it is going to go to a bordering State, six States away, or whether it is going overseas somewhere. So it is very difficult for workers in the United States to understand that what they are producing may be going into export markets, and their jobs exist only because of those markets.

I believe business firms are doing a better job today of making their employees understand that, but there is still a lot of progress to be made.

The fact is, there are attractive jobs in exports today because what we are exporting is what other people need and for which they are often willing to pay a premium. Their purchases are things where we have an advantage in knowledge, capital, or whatever it may be. That unique advantage over the rest of the world obviously gives us attractive jobs that accompany the export of high-quality goods.

To respond to the earlier part of your question, Mr. Chairman, about so much of our market now being outside the borders of the United States. Ambassador Kantor used the numbers this morning of 4 percent of the world's population being here and 96 percent outside our borders. One doesn't have to be a rocket scientist to figure out that most of our market is in that 96 percent, not in the 4 percent, and it is a market that is growing rapidly every day, particularly in Asia, of course.

Chairman CRANE. Thank you very much.

Mr. Gibbons.

Mr. GIBBONS. Thank you, Mr. Chairman.

Mr. Ambassador, it is great to see you back.

Mr. YEUTTER. Thank you.

Mr. GIBBONS. I remember your outstanding service to our country and to the cause of free and open markets and world peace.

Mr. YEUTTER. Thank you.

Mr. GIBBONS. You can be terribly proud of what you contributed, and I was happy that we could do it on a bipartisan basis.

Mr. YEUTTER. You bet.

Mr. GIBBONS. Let me ask you a simple question that hasn't got anything to do with this hearing at all. I am a lawyer, but I am a little out of touch. What does L.L.P. after your title mean? I noticed that, and I just thought I had better catch up real quick here.

Mr. YEUTTER. That just means it is a partnership, Mr. Gibbons.

Mr. GIBBONS. It means it is a partnership. Do you know what the letters stand for? I don't know.

Mr. YEUTTER. I don't think you will need to worry about that when you get back to the private sector, Mr. Gibbons.

Mr. GIBBONS. Nobody will want me.

Mr. YEUTTER. No, they are going to welcome you warmly, no matter what the label.

Mr. GIBBONS. Well, I just didn't want to express too much ignorance about the practice.

Do you foresee the need for any new international negotiation any time soon? What is your view of that?

Mr. YEUTTER. I have felt, Mr. Gibbons, ever since we were immersed in the Uruguay Round, we ought to have something approximating continual negotiations in the World Trade Organization.

Having complex rounds like the one recently concluded is a very difficult proposition. There is a lot of stress and strain and an enormous commitment of time involved in an exercise like the Uruguay Round.

It seems to me the world may have passed that process by. An additional reason, over and above the complexities of conducting such an exercise, is the world is moving so fast these days, one can't wait 10 years, as we traditionally have, for a round of negotiations.

Trade problems have to be solved promptly. Otherwise, they won't get solved by an international organization like the WTO. The WTO will run the risk of being irrelevant if it cannot respond in a timely way to the trade problems of the world.

So I believe one of the things we ought to be doing in Singapore is developing a modus operandi for dealing with issues when they arise.

We used to say,

> Well, the reason we can't do that is because you have to lump it all together in one big package at the end of the day, you sort of hide the tradeoffs, and you can then say to everybody, Well, you took it on the chin here, but you gain something there, and you had some good tradeoffs. Therefore, all in all, it was OK.

Most businesses, trade associations, and government officials are too sophisticated for that today. Those relatively unsophisticated arguments for saying yes to an agreement just no longer apply.

One has to be able to defend everything in an agreement on a specific case basis, and if we are going to do that we might as well negotiate them on a specific case basis. If there is going to be a problem in government procurement, let us negotiate government procurement. If it is in agriculture, let us do agriculture. If it is subsidies, let us do subsidies. There are plenty of tradeoffs within each of these.

So I think the World Trade Organization ought to crank up what is, in essence, a permanent negotiating process.

Mr. GIBBONS. Based upon your experience as a negotiator, is it possible for the United States to participate meaningfully in those negotiations without fast track?

Mr. YEUTTER. In general, the answer to that, Mr. Gibbons, is no.

We could do some negotiating without fast track. If it were a very simple, straightforward negotiation, we might well be able to have our negotiators bring it back to the Congress and have it make its way through without being destroyed by amendment, but those are exceptions, rather than the rule. They would be de minimis exceptions because 99-plus percent of the time, our negotiators are going to need fast track authority.

Mr. GIBBONS. My time has expired, and I would like to come back, Mr. Chairman, on that subject matter as soon as we get through with the rest of the Subcommittee.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much.

I will yield to Mr. Gibbons.

Mr. GIBBONS. I wanted to ask you a question about fast track. We seem to have hit a standstill on that subject matter here in the Congress. The Democrats are now insisting fast track procedures encompass not only trade legislation, but the parallel environment and labor standards. The Republicans differ from us on that.

I have tried to bridge the difference by suggesting that perhaps what we may do is have a compromise that would look something like this. You would, as USTRs can do now, go out and negotiate on all of these issues, but when the legislation is submitted to the Congress, we would have two parallel fast tracks that are not connected, one for the trade issues and one for the labor and environmental issues and let Congress have a chance at both of those on a parallel basis, but not connected with each other.

I don't know whether that will work or not. I don't know whether anybody will accept it or not, but I wanted to find some way we can break this stalemate we have right now, and I wouldn't call it a little stalemate because it has gone on for 1½ years.

Have you any ideas on what we ought to be doing?

Mr. YEUTTER. I haven't given the issue a lot of thought, Congressman Gibbons, although I have followed the debate and the views that have been articulated over the last 18 months or so.

The administration clearly overreached in this area at the time it sought fast track approval authority, and as a consequence, ended up with nothing. Their strategy and tactics, obviously, left something to be desired, but what is done is done. We can't go back and change that.

Mr. GIBBONS. That is correct.

Mr. YEUTTER. So, clearly, what you are looking to do is find a way to go beyond that.

My thinking, Mr. Gibbons, would be something like this. There is a lot of risk in having labor and environmental issues become immersed in traditional trade issues. There is great opposition to that by almost everybody else in the world, not all, but by a very large number of countries.

That suggests to me that if we want to get anything done with the rest of the world, then one has to either exclude labor and environmental issues, which would be the simplest way—the position my Republican colleagues have been taking—or if you are looking for compromise ground, it seems to me one has to find a way to dramatically limit what is going to be involved in the labor and environmental area.

I am not sure you can deal with that issue simply by having a dual track. I really believe, Mr. Gibbons, you are going to have to find a way to define precisely what we mean when we negotiate labor rights issues. For example, we will confine the negotiations to the following issues at which point we would name them and limit them to the most contemptible kinds of labor practices that exist in the world. There are some of those, as you well know.

In the environmental area as well, we would need to dramatically and significantly shrink the playingfield, if you will, to where the elements of the debate are something that would make sense to your Republican colleagues and to the rest of the world. Now,

that is probably going to be a lot less than what Ambassador Kantor and others on the Democrat side would prefer. But in my view, a proposed environmental agenda must either be shrunk down to a manageable situation, which meets the philosophical concerns of the Republican side, and lots of other countries, or the impasse is going to go on forever.

Mr. GIBBONS. I have tried to avoid that impasse forever. Wouldn't the USTR be somewhat limited in what areas he would want to negotiate in realizing he had to bring that back to Congress? He would have to limit his agenda and maybe he would be the better one to limit the agenda after he found out what the world was willing to do, rather than have Congress try to limit it in advance?

Mr. YEUTTER. Well, I think I could limit that agenda pretty quickly.

Mr. GIBBONS. That is our trouble. We all have independent views of what the agenda ought to be.

Mr. YEUTTER. Yes.

Mr. GIBBONS. I don't think that that would work too well if we don't work out some kind of compromise.

Mr. YEUTTER. I think it is a matter of confidence in how the authority would be handled, and with all due respect to the administration, I believe what you are seeing in the impasse is a lack of confidence on the Republican side as to how the authority would be used. If I am correct in that assumption, someone must take steps that would limit that authority in such a way the Republican side would be comfortable with it.

Mr. GIBBONS. Thank you for yielding to me.

Mr. YEUTTER. I wish I could be more specific, but I don't want in any way to usurp this.

Mr. GIBBONS. We are at an impasse now, and I am not capable of breaking it, but I am sure there are enough good minds out there somewhere that can break it.

Mr. YEUTTER. My personal judgment, Mr. Gibbons, is that it would not be terribly difficult to find a set of worker rights issues that would be of concern to all Americans because there are some deplorable conditions in worker rights that merit attention on a global basis.

In the environmental area, it becomes much more difficult to draw a dividing line, and I am not sure how I would do that one today.

Mr. GIBBONS. Thank you.

I have exceeded my time.

Chairman CRANE. Mr. Rangel.

Mr. RANGEL. Mr. Ambassador, it is nice to see you again.

Mr. YEUTTER. Thank you, Mr. Rangel. It is nice to see you.

Mr. RANGEL. On the labor and environmental conditions, normally trade is operated in a bipartisan way, but I think it is safe to say that on most of the issues that have come to the Congress, the Republicans are locked into the philosophical revolution. So, normally, we don't get an opportunity, not meaning we don't want to, but when you are following a master plan for a revolution, you don't have time to chitchat with those people that are not a part

of it or the other side of it or those people who are considered to be the problem. So, so much for getting together.

The moral question as to whether or not it is fair to American workers to ignore the environment and to ignore workers' rights when they are competitors, too, we'll set that aside.

The political problems some of us will have, even if we really are 100 percent for increasing trade and cooperation, are that those that support us may make it appear as though we are just competing, and say thank God, you got those worker protections here, but we cannot superimpose all those high standards on developing countries, and put that aside.

So that leaves me with the question of having these things thrown on our U.S. Trade Ambassador, and I know how you diplomats don't like to deal with these things. Just how heavy a weight has it been as you have successfully negotiated what have been considered the most complex and successful international treaties? What problems has it caused, and why would you say, notwithstanding that it is political luggage, that is not a part of your portfolio? Why would you say it would be best just to get rid of it?

Mr. YEUTTER. Mr. Rangel, we raised the worker rights issue all the way back to Punta del Este in 1986. So there has been a lot of discussion of worker rights in the GATT context, and now the WTO context, over a period of years.

The rest of the world was singularly unenthusiastic about doing anything on that subject, initially on having a working party begin to do some preliminary analyses of the issue at the time I was USTR.

We have made a little progress over the last decade, partially because some of the more deplorable practices have made major headlines around the world. People—not just in the United States, but elsewhere too—are beginning to say that it is time to take some global action in this arena.

I don't believe it would be impossible to get that issue on the WTO agenda if it were sufficiently circumscribed and the foundation carefully laid with our major negotiating partners.

It would still be highly controversial, and getting a negotiated work product that would be satisfactory to 100-plus nations is not going to be an easy task, but I do not view it as an impossible task.

The environmental issue is much more difficult. At the moment, there would be very little international support for dealing with the environment in a trade policy context in the WTO, and if we can't persuade the rest of the world to do something, we are just spinning our wheels and wasting our time.

Right now we are nowhere near being able to persuade the rest of the world what it is we want to do in the environmental area and why we want to do it. Maybe that is our fault as a nation for not having effectively articulated what it is we want to achieve and how we wish to go about it, but whatever it is, it sure hasn't sold until now.

I do not believe near-term environmental negotiations are a feasible proposition unless we drastically reduce the scope of what we might attempt to do within the WTO.

Just as is the case here on Capitol Hill, Mr. Rangel, the question is, Do we want to have a geopolitical issue or do we want to accomplish something? If we want to have a geopolitical issue and a global environmental revolution, then we can talk about the environment in the context of the WTO forever and not get anything done.

If we want to achieve something in the environmental area in the WTO, we had better narrow our focus and our sights.

Mr. RANGEL. To your knowledge, has anyone indicated as to what can be achieved, how it could be achieved, and does our U.S. Trade Representative feel comfortable with it?

Mr. YEUTTER. I am not privy to those discussions, Mr. Rangel. So I really can't provide you with an answer to that.

Mr. RANGEL. For 26 years, I have been asking that narcotics be placed on the trade agenda, and people looked at me like I was a wide-eyed Communist saying this is apples and oranges. My Chairman would beat up on me and say, Rangel, would you please give them a chance to do what they are trained to do. Now Ambassador Kantor has informed me it is a part of our considerations in doing trade. I just hope these things that are so difficult for diplomats to deal with with host countries, that you help us define a way to do it without restricting your ability to do the best for our country.

It is good seeing you.

Mr. YEUTTER. Thank you.

I would simply add to that, Mr. Rangel, the agenda of the WTO is a whole lot broader than the agenda of the GATT 15 years ago. We broadened it a great deal through the Uruguay Round. So it is not impossible to get additional subjects on the agenda, but neither is it easy.

As you know, we spent 24 hours a day for about 5 days in Punta del Este to get the five topics I was talking about on the Uruguay Round agenda over an enormous amount of resistance from an awful lot of folks, including a lot of our friends. So we have to have perseverance, determination, skill, finesse, and good ideas if we are going to pull that off.

Chairman CRANE. Again, I want to thank you so much, Clayton, especially for your patience because of the time constraints, and I trust you had a good lunch, I hope and pray.

Mr. YEUTTER. Thank you.

Chairman CRANE. We appreciate your giving of your time so generously.

Mr. YEUTTER. It is wonderful to be here with all of you.

Chairman CRANE. We look forward to it again.

Our next panel is Hon. Jim Bacchus, a former colleague and member of the Appellate Body of the World Trade Organization, and Curtis Barnette, chairman and chief executive officer of Bethlehem Steel Corp., who is here on behalf of the American Iron and Steel Institute.

If you gentlemen can come forward and take seats, and let me, if I might, Jim, just make the request that if you could try and keep your presentation to roughly 5 minutes, any additional comments will be made a part of the permanent record.

Would you proceed, Jim.

STATEMENT OF HON. JIM BACCHUS, MEMBER, APPELLATE BODY, WORLD TRADE ORGANIZATION; AND FORMER MEMBER OF CONGRESS

Mr. BACCHUS. Mr. Chairman, would you like for me to begin?

Chairman CRANE. Please.

Mr. BACCHUS. Thank you, Mr. Chairman. Thank you very much.

I recall the days in which I was privileged to serve in this House. I hoped many times that someone who was asked to summarize their remarks would actually do it, and I will try very hard to do that. I have prepared some remarks for the record, and I invite you to read them and to deliberate on them.

I will content myself with just a few words, if I may, about the Appellate Body of the World Trade Organization and about my new work there, but first, I wanted to say thank you to you, Mr. Chairman, and to all of my colleagues on both sides of the aisle for your support of my nomination by this country to serve on the Appellate Body of the WTO.

I want specifically to thank you, sir, and I want to say a good word, if I might, about my longtime friend, Sam Gibbons.

Sam has known me since I was a teenager, and he taught me a lot of all I seem somehow to know about trade, which is not nearly enough. So Sam is to blame if I go astray. He is a fine mentor. He will soon be joining me in retirement, but I think he has many years yet left to serve.

I have listened to Ambassador Yeutter and Ambassador Kantor today talk about the benefits to this country of participating in the World Trade Organization, and I wholeheartedly endorse everything that they both said about that.

I would like to point out that you, Mr. Chairman, Sam, Ambassador Yeutter, and Ambassador Kantor are examples still of why we have had such a successful trade policy over the past half century. We have had a successful trade policy because we have had a bipartisan trade policy, and I believe we should continue to do so, no matter who is President, no matter who is in control of Congress at any given time. We need to work together in trying to advance the cause of trade.

Over the past half century, we have done that in this country by supporting the growth of the GATT from its infancy into the transformation now of the GATT into the new World Trade Organization. We have done that because it was very much in our interest to do so as a nation. It was the right thing to do, but beyond that, it was in our interest to do so because, as the world's largest trading nation, as the world's largest economy, we stand to profit the most when trade barriers go down worldwide.

By working multilaterally, we can reach better arrangements to reduce those barriers worldwide. So we have supported the growth of the WTO to the point where it is now. But a key to the success of the WTO and a key to the success of the multilateral trading system is whether we feel we can rely on that system to resolve the trade disputes we have with other nations.

Historically, we have been frustrated. From time to time, time after time, we have gone to the GATT to try to resolve a dispute and found it could not be resolved. We had no right to sue. We had no right to a decision within a certain time. There was no one to

whom we could appeal. There was no way to get a decision in our favor enforced, and we won 80 percent of the cases, over 50 years.

So it became a high priority of our trade negotiators during the Uruguay Round to change that, and they succeeded. To their credit, by virtue of their skill, they succeeded, and we have a new dispute settlement mechanism in which there is now a right to sue. There is now a right to a decision within a certain time. There is now a right to appeal to the new Appellate Body, which is charged with trying to enforce the trade rules that America has embraced.

We are beginning to do that. The Appellate Body was appointed in December. We promulgated our working procedures in February. We are considering now our first appeal. The system is working in many, many ways.

Ambassador Kantor mentioned a few instances this morning of cases that had been resolved because the other party to the dispute understood they might lose.

I will stop now, but I would like to say I would be happy to address general questions about the WTO and the Appellate Body. For understandable, obvious reasons, I would hope, I can't get into the specifics of any case that might come before the Appellate Body or the specifics of any particular dispute that might eventually get there.

[The prepared statement follows:]

STATEMENT OF HON. JIM BACCHUS
MEMBER, APPELLATE BODY
WORLD TRADE ORGANIZATION

Mr. Chairman, thank you for inviting me to return to this House.

This is my first time and my first testimony on Capitol Hill since I retired from the Congress.

I am proud to have served here, and I am happy to return here to share with you how I am serving in a new way as a member of the Appellate Body of the World Trade Organization.

I am grateful to the President of the United States for nominating me for the Appellate Body.

I am grateful to Ambassador Mickey Kantor for his strong and steadfast support.

And I am equally grateful to my former colleagues on this Committee and in this House - - on both sides of the aisle - - for your encouragement and your endorsement.

I am especially proud of the bipartisan support my candidacy received from many who have known me and worked with me in this House.

In particular, I want to express my gratitude to you, Mr. Chairman. And I want also to thank a good friend and great man who will soon be joining me in retirement, Congressman Sam Gibbons of Florida.

Through the years, Sam has said more times than either he or I can remember that the key to the continued success of American trade policy worldwide is bipartisanship on trade issues here at home. As usual, I agree with Sam.

And I think Sam will agree with me that my new service on the Appellate Body is best understood in the context of the longstanding bipartisan policy-making that has led after nearly fifty years of trying to the creation of the WTO.

For half a century, the United States of America has pursued a bipartisan policy aimed at creating and strengthening an ever-opening and ever-expanding world trading system.

With Adam Smith, with David Ricardo, and with virtually every reputable economist of the past century, we Americans have believed that trade is not a "zero-sum" game. With the late John Kennedy, we have believed that "a rising tide lifts all the boats." And, with these beliefs, we have lifted the rising tide of world trade.

For the most part, we have done so through our leadership in the General Agreement on Tariffs and Trade, the GATT, based in Geneva, Switzerland.

We Americans led the way in negotiating the GATT following World War II as part of the Bretton Woods system that has defended democracy, defeated communism, and brought the world unprecedented prosperity. Since then, we have nurtured the GATT from an orphan infancy to a promising maturity in its new role as the World Trade Organization.

With our leadership, the GATT has grown from an institution by default, with just 23 members who shared only a fraction of world trade, into an institution by design, the WTO, whose nearly 120 members account for more than 90 percent of world trade.

On a bipartisan basis, Congress after Congress and Administration after Administration have led the world year after year and decade after decade through round after round of GATT-sponsored multilateral trade negotiations.

First under the auspices of the GATT and continuing now under the new framework of the WTO, we have negotiated tariff cuts and entered into other historic

trade agreements that have helped multiply the volume of world trade many times over, from just $300 billion in 1950 to $3.5 trillion last year.

Every nation in the world today is either a member of the WTO or wants to be. And politically, economically, diplomatically, and legally, the world trading system born in the GATT and institutionalized now in the WTO is in many ways a reflection of and the creation of the United States of America. The WTO is both a custodian and a beacon for a more open multilateral trading system that is based on the values of freedom and free enterprise that we cherish as Americans.

Unquestionably, creating this trading system for a world that had been impoverished by economic depression and devastated by total war was the right thing to do.

Yet we Americans have not sought a more open world trading system because it was the right thing to do. We have not done so as an act of altruism. We have not done so as some self-sacrificing ploy of foreign policy. We have not done so because it is in the national interest of other nations. We have done so because it is very much in our national interest.

Yes, other nations have profited along the way. Other nations have grown as we have grown. Yet our belief - - our bipartisan belief - - has been that we can profit from the growing prosperity of others. And, because we are so large, and because we have so many goods and services to offer growing nations, we can often profit more.

Trade is not a favor we do for other nations. Trade is a necessity we pursue for ourselves.

We have the largest economy in the world. We stand to benefit more than any other nation in the world from the increased growth of the world economy that is made possible by a more open world trading system.

We are the largest trading nation in the world. We have the most to gain in jobs and profits from multilateral agreements that lower trade barriers worldwide.

We have just four percent of the world's population. Our ability to enhance our own growth depends on continued world growth and on our continued and increased access to the 96 percent of the world's consumers who are not Americans.

More than 30 percent of the American economy is now related to world trade. One-third of the new jobs created in America last year were related to world trade. Trade-related jobs pay more than other jobs. More than any other nation, we have the most to gain from more trade, and we have the most to lose from less.

Republicans and Democrats alike, we have long understood our compelling national interest in gaining more from more open world trade. We have long understood our national need for an international trading system that is more open, more stable, more predictable, more reliable, more efficient, and more secure.

On a bipartisan basis, we have understood that we cannot import nothing and export everything. We have understood that we cannot close our doors to others and expect them to open their doors to us.

Of course, we have understood that we must enforce our domestic laws, oppose unfair trade practices, and make adjustments from time to time to accommodate changing patterns of world trade. The GATT permits this.

Yet on a bipartisan basis, we have understood that we simply cannot afford not to trade. So we have tried our best to open doors and not to close them. And we have used the GATT as the door key.

The Uruguay Round unlocks the door to a bright future for the world economy and the world trading system. The Uruguay Round is the most recent and most significant bipartisan achievement of American trade policy and the most significant achievement also of the GATT. Nearly a decade of complex and sometimes contentious negotiations among more than one hundred nations culminated in important new rules that can help stimulate unprecedented new growth in America and throughout the world.

The new rules written by the trading nations of the world in the Uruguay Round add up to many landmark accomplishments -- the additional market access through tariff cuts that amount to the biggest tax cut in the history of the world. The full inclusion of many developing countries in the GATT system for the first time. The broadening of GATT jurisdiction to include all trade in both manufactured and agricultural goods as well as textiles. The inclusion under the GATT for the first time of trade in services, intellectual property, and investment. The transformation of the GATT after fifty years into a true institution that can do much in the years ahead to strengthen the multilateral trading system - - the WTO.

Yet these and other accomplishments of the Uruguay Round will not be assured unless the rules of trade are enforced fairly, consistently, and effectively.

The multilateral trading system will not generate the increased growth we seek and sorely need unless the nations within the system abide by the rules of trade. And nations will not abide by the rules unless they know that the rules will be enforced and enforced evenhandedly. Most especially, nations will not rely on the multilateral system to resolve their trading disputes with other nations unless they know that the system is truly capable of resolving their disputes and resolving them expeditiously and impartially.

For this reason, perhaps the most significant of the many accomplishments of the Uruguay Round may prove to be the creation of the new dispute settlement system of the WTO. The central "check and balance" of that new system is the newly created Appellate Body on which I am privileged to serve.

For obvious reasons, I am not free to discuss any specific disputes that may ultimately be resolved by the Appellate Body.

Nor would it be advisable for me to delve too deeply into any specific issue that might give rise to a dispute. That might lead to a call from another nation for my recusal from decision-making in that dispute.

Yet I am free to offer some general reflections on the rationale for the new dispute settlement system.

For decades, the United States was frustrated by a GATT dispute settlement system that was often incapable of resolving disputes - - a system that was frequently, and often justifiably, derided as the "General Agreement to Talk and Talk." For all the many accomplishments of the GATT, the GATT nevertheless remained far from reliable as a forum for resolving international trade disputes.

When we had a grievance against another nation, we had no right to an impartial panel to resolve the dispute. When we managed somehow to secure such a panel, we had no right to a decision by the panel on our dispute within any certain time. And, when we finally won a decision from a panel on a dispute, we had no right to have that decision enforced. The other nation involved in the dispute could block an adverse panel decision indefinitely - - and often did.

Time and again, we Americans have been frustrated by our inability to enforce the GATT rules against nations that have violated those rules. When this has happened, our tendency and that of other nations that have been similarly frustrated has been to seek other "bilateral" solutions. And the multilateral system in which we have such an interest as a nation has suffered accordingly.

No nation is perfect, but, by and large, the United States abides by the rules of trade. Thus, we stand to benefit significantly from a "rule driven" system in which the rules are enforced.

Knowing this, the Congress of the United States and successive presidential administrations of both parties made the improvement of the GATT dispute settlement system a major negotiating goal of the United States in the Uruguay Round. We sought a new system in which the rules of trade would be enforced fairly, consistently, and effectively.

To the credit of our negotiators, we accomplished that goal.

The "Dispute Settlement Understanding" that is one of the key Uruguay Round trade agreements has created a dispute settlement system in which the world trade rules that we Americans have long sought, and to which we Americans have agreed, will, at long last, be enforced.

For the first time, the United States has the right to sue another nation for violating the rules of trade. For the first time, we have a right to a decision in such a suit within a certain time. For the first time, we have certainty that a decision will be enforced. And, for the first time, we have a right to appeal an adverse decision to make certain that the world trade rules are appropriately enforced.

The Appellate Body was created to hear and decide such appeals.

There are seven members of the Appellate Body. The other six are distinguished jurists and statesmen from Germany, New Zealand, Egypt, Uruguay, Japan, and the Philippines. The seven of us were chosen by the World Trade Organization from among several dozen nominees from around the world. We were appointed in December, published our "working procedures" in February, and are working now on our first appeal.

We have sworn to enforce the rules. We are resolved to be impartial and independent in our decision-making. We share a common commitment to the integrity and the future of the world trading system.

In keeping with the strictures of the "Dispute Settlement Understanding," three of us will serve as the decision-makers on any given appeal. We will rotate as decision-makers from appeal to appeal in an essentially random way. For all practical purposes, the decisions we make on appeals will be final. Any decision we make will be binding on the parties to the appeal unless every member nation of the WTO agrees that it should not be.

About two dozen additional trade disputes for which consultations have been sought or panels have been convened already are making their way through the new dispute settlement system. Numerous other disputes have been resolved without litigation - - perhaps because the parties to those disputes have realized that the rules will indeed be enforced.

The new system is working, and some of the other member nations of the WTO are puzzled that some in our nation, of all nations, are complaining about it. They are worried that these complaints are evidence of a diminished American commitment to a system that our nation, more than any nation, has created, and to a cause in which our nation, of all nations, has the most at stake.

It may be worth repeating that the new dispute settlement system of which the Appellate Body is a part is not a system that has been imposed on the United States by other nations. It is one that we sought on a bipartisan basis as a major goal of our trade negotiations.

Moreover, the rules the Appellate Body will be enforcing are not alien rules that have been imposed on the United States by foreigners. In most instances, these are rules

that we Americans have sought because we Americans have believed that the existence and the enforcement of such rules would enhance our economic growth. And, in every instance, these are rules to which we have agreed in international trade accords.

The enforcement of these rules by the Appellate Body and by the World Trade Organization will not affect American sovereignty. The WTO cannot change American law. Only the Congress can do that. The WTO cannot change our administrative rules and regulations. Only our government can do that.

The GATT is a contract. Historically, member nations of the GATT have been called "contracting parties." As with any contract, there are both benefits and obligations to being a "contracting party" to the GATT. And if the obligations of the contract are not met, the risk is that the benefits of the contract will be lost by the party that has not met its obligations.

A suit to enforce GATT rules is essentially a suit for breach of contract. If the United States loses a suit in the WTO, we have a choice. We can choose to remedy our breach - - by deciding entirely of our own accord to comply with the GATT by changing a law or a regulation or a practice that has been held to violate the world trade rules. Or we can choose instead to forfeit some of the benefits we would otherwise have under the GATT contract - - by paying "compensation" in the form of a concession in another area of trade to the other country that is a party to the suit, or by relinquishing some of our access to the market of that country.

We might do well to remember the tacit leverage we have as the world's largest trading nation. As vital as trade is to us, our domestic market is so large that for the vast majority of nations, access to our market is far more important to them economically than access to their market is to us.

Where potential penalties for noncompliance with GATT rules are concerned, no loss by the United States to another nation in the WTO is likely to be as costly to us as a loss to the United States would be to almost any other nation. Thus, a system that enforces the rules of world trade fairly and consistently is a system that offers a powerful incentive for other nations not to engage in unfair trade practices against the United States.

We represent 20 percent of the world economy. Admittedly, we are just one of many nations in the WTO. Yet those other nations would tell you that inevitably we exercise significant sway in the councils of the WTO. In the internal parlance of the WTO, we are a "major player." And we will continue to be so.

To cite just one example, there has not been an actual vote in the GATT in about forty years. The WTO continues to adhere to the GATT practice of decision-making by consensus. And in striving for consensus in an economic institution, the views of the largest economic power in the world simply cannot be ignored.

Such subtleties should be considered by those who shout shrilly and simplistically on the political stump that the United States should abandon the WTO and retreat from our long-standing bipartisan commitment to a more open multilateral trading system.

Whether we remain in the WTO is entirely up to us. Consistent with the rules of the Uruguay Round, our law allows us to leave the WTO with six months' notice. But what would happen if we did?

If we left the WTO, we would lose the benefits we have gained from nearly fifty years of global trade negotiations. We would lose the low - - and often non-existent - - tariffs that ease our exports to other nations. We would lose the legal assurances we have against the further proliferation of a host of non-tariff barriers to our trade. We would lose much of the access we have to growing markets abroad for our manufactured goods, our agricultural goods, and our services. We would lose the new rights we have negotiated to defend the copyrights, trademarks, patents, and other intellectual property

that are a growing component of the real value in our international commerce. We would lose much of our access to the huge government-procurement markets in many countries. We would lose the established international rights we have to counter dumping, subsidies, and other unfair trade practices by other nations. We would lose countless rights that have long been established multilaterally, and we would therefore be compelled to conduct literally hundreds of negotiations bilaterally to restore basic trading rights we have long assumed.

And if we left the WTO, we would also lose much, much more. For without the United States of America, the WTO would weaken and wither away. Without the United States, the WTO would become a commercial "League of Nations" incapable of enforcing the rules of trade. The emerging rule of law in world trade would be replaced by a ruinous reign of commercial chaos, confusion, and collapse.

Past agreements would unravel. Trade barriers of every kind would rise. Trade volume would shrink. Financial markets and stock markets would suffer. Autarchy and economic anarchy would prevail. Every trade dispute would threaten to "spill over" and become a political confrontation, with uncertain consequences for our national economy and our national security.

And if, from dire necessity and sheer desperation, the other nations of the world somehow succeeded without our help in establishing some new world trade institution in place of the discarded WTO, what kind of institution would it be? Would it be one that shared our values? Would it be one that served our interests? Would it be one made in our political, economic, diplomatic, and legal image like the WTO? Or would it be instead what its American critics accuse the WTO of being in their flights of rhetorical fancy? Would it be an institution that would ignore our legitimate concerns, undermine our values, and act as a forum for those who truly do oppose our national interests?

Far better for the United States to remain in the WTO. Far better for us to continue to abide by the rules of the WTO while making certain that those rules are enforced worldwide. Far better for us to maintain the bipartisan trade policy that has led us to so much prosperity in this century and can lead us to still greater prosperity in the next century.

Without our continued leadership, the WTO will fail. With our continued leadership, the WTO can do more good for America and more good for the world in the next century than any other international institution.

I remain very much an American. I was proud to serve my country in this House. In serving on the Appellate Body of the WTO, I believe I am continuing to serve my country. For whatever the passing pressures, whatever the posturing and the pandering of the political season, I believe the abiding, overriding, and compelling national interest of the United States of America is in strengthening the world trading system by supporting the World Trade Organization.

A successful WTO will stimulate the continued growth of world trade. Trade leads to prosperity. Prosperity leads to peace. Prosperity and peace lead to freedom.

What could be more in our national interest?

Chairman CRANE. Thank you.
Mr. Barnette.

STATEMENT OF CURTIS H. BARNETTE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BETHLEHEM STEEL CORP.; ON BEHALF OF AMERICAN IRON AND STEEL INSTITUTE'S U.S. MEMBERS

Mr. BARNETTE. Mr. Chairman, thank you for this opportunity to appear before you today. It is good to be back with you again.

I want to especially thank this Subcommittee and the Senate Finance Committee for its leadership in bringing about the Uruguay Round and NAFTA. I would especially like to express my commendation to Mr. Gibbons.

I am very privileged to know you, sir, and work with you over the years, and I offer my compliments to my fellow panelist who takes on a new and august position in the administration of international trade administration of disputes.

With respect to our views, I represent the American Iron and Steel Institute, specifically our U.S. member companies. We have supported GATT. We have supported NAFTA, even though in many respects, Mr. Chairman, certain of those provisions were certainly trade law-weakening provisions, as we looked at the trade horizon.

I think it is too early to fully evaluate the Uruguay Round. So our comments will have to do more with conditions that will help lead to what we hope will be the true long-term success of the Round.

One key measurement will be the continued effective functioning of our trade laws, helping create conditions of fair trade, as well as free trade.

The steel industry is an example. It was referred to earlier this morning by Ambassador Kantor and others. It is an example of why our trade laws are so essential for the effective functioning of a basic domestic industry.

Today, our industry is the low-cost, high-quality supplier in this marketplace. We have increased our percentage of participation in the domestic marketplace. We are now a substantial exporter into the international market. Much of this was made possible through the effective operation of our trade laws.

Just in 1993, through the so-called flat-rolled cases at that time, unfair trading margins approaching 37 percent were found and duties of up to $150 per ton of steel were imposed as a result of the effective administration of our trade laws. These cases have been essential to the competitiveness of our industry.

Foreign steel producers today still trade unfairly in the world market. Cartel operation, subsidies, and dumping continue. The United States is truly the only free market in the world. There is 100-million-tons-plus of excess capacity out there. So we see the effective functioning of our laws as nothing less than essential, and by that, of course, I mean antidumping law, countervailing duty law, and section 301.

There are, perhaps, five areas that would be worthy of consideration in terms of the conditions that will let us see an effective and long-term implementation of the Uruguay Round system.

First, there is pending H.R. 2822, the so-called Temporary Duty Suspension Act. We urge the Subcommittee, if that legislation is to proceed further, and we do oppose that legislation, to avail itself of a full hearing. We have filed our comments and concerns about this particular bill.

Second, there are loopholes in related party transactions that simply permit the circumvention of orders that exist, and there are remedies that could be adopted to deal with that.

Third, we have the circumstance that those injured and aggrieved under our trading system have no compensation for the damage and injury they have suffered. There may be opportunities to deal with compensation.

A fourth area is a World Trade Organization Settlement Review Commission, H.R. 1434, sponsored by Congressmen Houghton and Levin, and in the Senate, S.16, by Senator Dole. This is a very effective manner in which to help ensure the integrity of the dispute resolution process of the WTO. We think this is legislation that should be moved along and acted on promptly.

Finally, the ability of private parties to participate in WTO panels and proceedings would be a fifth area that we would urge consideration by the Subcommittee in due course.

So, for these reasons, we would urge continued effectiveness of our trade laws, improving them where that is appropriate, and with great hope we will see a successful implementation of the Uruguay Round through the WTO.

Thank you, Mr. Chairman.

[The prepared statement follows:]

TESTIMONY OF CURTIS H. BARNETTE
CHAIRMAN AND CEO, BETHLEHEM STEEL CORPORATION
ON BEHALF OF
THE AMERICAN IRON AND STEEL INSTITUTE'S U.S. MEMBERS

SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
MARCH 13, 1996

I appreciate the opportunity to testify on behalf of U.S. members of the American Iron and Steel Institute (AISI) regarding the Uruguay Round and its implications for U.S businesses and trade laws.

At the outset, let me state that AISI supported both the Uruguay Round and NAFTA trade agreements. We supported the Uruguay Round notwithstanding strong concerns over provisions that weakened the laws against unfair trade or made them more costly to use. The U.S. business community worked hard to help ensure the successful completion of these ground-breaking initiatives, and has a great deal at stake in seeing that they succeed. The Congress, and this Committee in particular, deserve many thanks for their efforts to improve upon and enact the implementing legislation for both the Uruguay Round and NAFTA.

While the Uruguay Round agreements hold great promise for American businesses, we must be vigilant in monitoring how the agreements are implemented, how the World Trade Organization (WTO) operates and how they impact on the United States. We signed a trade agreement, not a blank check. We must constantly ask ourselves, as this Committee is doing today: Are American interests being served? Is American sovereignty fully protected? Are our trade laws functioning effectively? Are American workers and businesses sharing in the gains from expanded world trade?

It is too soon to have full answers to these questions. We can, however, comment on what we believe are necessary conditions for the long-term success of the Uruguay Round agreements.

Importance of U.S. Trade Laws

We should not lose sight of the fact that the effective functioning of our own trade statutes -- especially countervailing duty law, antidumping law and Section 301 -- is key to the success of the Uruguay Round and to the liberalization of international trade in general. They are absolutely essential to the competitiveness of U.S. businesses and to the creation of truly free and fair markets in the United States and overseas.

The steel industry is an excellent example of why we need strong trade laws. Since 1980, our industry has taken the difficult and often painful steps necessary to become a reliable supplier of low-cost, high-quality steel products to the U.S. market. We have downsized, restructured and modernized, more than doubling our labor productivity since 1982. At the same time, we have expanded exports and increased market share against key

foreign competitors. This has all been done without significant government subsidies. Let there be no question -- U.S. steel producers can compete against fairly-traded imports.

The steel industry is a global industry and U.S. producers are active participants in it. That is why we have consistently supported trade agreements that assure both free and fair trade. In fact, U.S. steel exports increased by 85 percent from 1994 to 1995, reaching their highest level since 1940.

The problem is that foreign steel producers and their governments have too often refused or been unable to make the difficult choices necessary to assure fair competition in the international market. The U.S. steel industry still confronts millions of tons of unneeded, excess steelmaking capacity owned by foreign producers. This surplus foreign production is made possible by protected home markets, private cartel practices and huge government subsidies -- more than $100 billion since 1980.

It is no wonder that protected and subsidized foreign producers look to the U.S. market -- the largest and most open in the world -- to unload their excess production. The U.S. steel industry has seen massive, unprecedented dumping by foreign producers and subsidies by foreign governments, as evidenced by unfair trade margins averaging 37 percent (or $150 per ton) in the 1993 flat-rolled cases. Without effective U.S. laws against unfair trade, we become vulnerable targets of dumping by foreign competitors. With effective trade laws, it becomes more difficult for foreign competitors to hide behind government subsidies, protected home markets and private anticompetitive practices, which the Uruguay Round does not address at all.

The situation faced by the steel industry is not unique. Over the past decade, many strategic industries -- including advanced materials, semiconductors, and others -- have faced intense dumping and other unfair trade practices by foreign competitors. No matter how productive U.S. companies are, we cannot compete over the long term with foreign producers whose prices are not based on market forces.

In a world where government intervention and restrictive business practices are widespread, domestic political support for an open U.S. market and a liberal trading order has been sustained, in large part, by the existence of effective trade remedies against dumping and subsidized imports. These laws remain essential in countering foreign practices that are inconsistent with the functioning of a market economy.

Antidumping and anti-subsidy rules play a vital role in maintaining the delicate balance that the WTO system must strike between the goal of trade liberalization and its members' national political and economic interests. These rules reduce the friction arising out of competition between economies with fundamentally different structures. In the absence of effective remedies against dumping and subsidies, we do not believe there would be the necessary political support for the progressive dismantling of trade barriers.

It is noteworthy, for example, that highly protectionist countries virtually never use antidumping measures. There is no

need to do so because imports are systematically suppressed by administrative measures and restrictive private practices.

The nations that use antidumping measures most extensively tend to be the most open and liberal economies -- the United States, Canada, the European Union and Australia. During the past century, these countries were able to form a domestic political consensus in favor of dismantling their own trade barriers. They did so, in significant part, because they enacted laws against unfair trade concurrently with trade liberalization measures. This was required to help reassure domestic constituencies that market-opening would not expose their economies and workers to damaging imports by foreign cartels or by government-subsidized products.

Following this same pattern, as newly-industrializing countries such as Korea and Mexico have moved to liberalize their economies, they also have increasingly adopted laws against unfair trade as part of the process. In so doing, they have abandoned economy-wide protective measures in favor of case-by-case administrative procedures limited to specific cases of injurious dumping and subsidization. Their adoption of trade laws in lieu of permanent forms of protection is strengthening -- not weakening -- the world trading system.

Preserving and Strengthening the U.S. Trade Laws

An integral part of our assessment of the Uruguay Round agreements is their effect on our trade laws. Ultimately, our ability to deter foreign producers from taking unfair advantage of the open U.S. market will do as much to promote world trade as the agreements themselves. In several respects, the Uruguay Round -- including, as examples, higher standards for determining whether petitioners have standing to request an investigation; the requirement to conduct "sunset" reviews in every proceeding; new and potentially troublesome rules for antidumping comparisons; and greenlighting of certain categories of trade-distorting subsidies -- weakened our trade laws and has resulted in less effective U.S. trade remedies.

Despite these problem areas, there were a number of provisions that improved the trade laws and we strongly supported the Uruguay Round agreements and implementing legislation. We particularly appreciated the work of this Committee and that of the Senate Finance Committee in developing the implementing legislation.

We believe that Congress must avoid any further weakening of our trade laws. In addition, there are actions we should take to make these laws more effective. In this context, let me briefly comment on several specific proposals.

Temporary Duty Suspension. AISI has already responded to the Subcommittee's invitation to comment on the proposed Temporary Duty Suspension Act and I hope the Subcommittee will hold hearings on this subject before taking action. We believe a Temporary Duty Suspension Act would amount to a "Trade Law Suspension Act" by undermining the purpose and effectiveness of U.S. antidumping and countervailing duty laws.

Duty As A Cost. Existing U.S. law has a loophole that allows foreign exporters to avoid the full impact of an antidumping order by importing the product under order through a "related party" and then indirectly reimbursing that party for the duties paid. In this way, foreign exporters maintain market share and circumvent the intended effect of antidumping law.

Legislation should be adopted that would include antidumping duties imposed in related party transactions as a cost in determining the export price or a constructed export price in administrative reviews. Under this proposal, the Department of Commerce would have the authority to self-initiate an absorption investigation but, in general, the initial burden would be on petitioners to come forward with some evidence of absorption. Such evidence might include flat or declining transfer prices or some other indication that the exporter was indirectly reimbursing its related party importer.

Compensation. The present system does not allow for any reimbursement of funds to injured U.S. manufacturers that are seeking relief from unfairly-traded imports. The trade laws are designed to provide relief for post-determination sales of dumped or subsidized products. They do not compensate industries in any way for injury caused by dumping or subsidization that occurred prior to the issuance of an antidumping or countervailing duty order. Even after duties are imposed, injured manufacturers are left damaged, struggling and less able to compete. Compensation payments to U.S. producers who receive affirmative injury determinations would allow those injured parties to invest and remain competitive.

Such a provision is crucial to U.S. manufacturers since, in many cases, the trade laws' new "sunset" rules will terminate the relief from unfair trade practices after five years. This short time period for relief will be a major disincentive for capital-intensive industries to reinvest. Compensation awards will improve reinvestment during the window of relief and help struggling domestic producers to regain their competitiveness.

A compensation mechanism should be at least revenue neutral as (1) compensation would be funded by antidumping and countervailing duties collected, and (2) the money disbursed by the Treasury would in any event be offset by increased tax revenues from capital spending and the retention of jobs by more competitive producers. Moreover, the petitioning industry would only receive compensation if the foreign exporter continued to benefit from subsidies or dump its products in the U.S. market. If, after an administrative review, the foreign exporter were found to have ceased dumping or benefitting from subsidies, it would get a refund of its duty deposit and the petitioning industry would not receive compensation.

The Crucial Role of H.R. 1434

The WTO Dispute Settlement Review Commission Act, H.R. 1434, would provide an indispensable tool to help Congress, U.S. businesses and the American people determine whether the Uruguay Round agreements are serving our interests. This bill has been

introduced by Congressmen Houghton and Levin and a companion bill has been introduced in the Senate by Majority Leader Dole. In particular, this legislation would help us determine whether the WTO dispute resolution system is operating in an equitable and impartial manner. Make no mistake -- U.S. businesses will not benefit under the new world trading system unless disputes are settled in an expeditious and fair manner, and unless there is confidence in the integrity of the WTO's decisions. That is why this legislation is so important to the business community and why it is so crucial to the ultimate success of the Uruguay Round.

Mr. Chairman, I have the privilege of serving on the President's Advisory Committee for Trade Policy and Negotiations (ACTPN), which is the President's most senior private sector trade advisory group. The ACTPN has specifically reviewed the WTO Dispute Settlement Review Commission Act and has adopted a statement endorsing the concept of judicial review of WTO dispute settlement panel decisions. The ACTPN endorsement reflects the broad-based support for close monitoring of the WTO panel process.

The Houghton-Levin and Dole bills represent a bipartisan effort that would establish a WTO Dispute Settlement Review Commission. This Commission would be composed of five federal judges and would review WTO panel decisions adverse to the United States. The Review Commission would determine whether the WTO dispute resolution panel: (i) exceeded its authority, (ii) added to the obligations or diminished the rights of the United States under the Uruguay Round, (iii) acted arbitrarily, capriciously, or engaged in misconduct, or (iv) deviated from the applicable standard of review.

If the Review Commission determined that a panel report is flawed in one of these respects, any Member of Congress could introduce a privileged resolution directing the President to negotiate modifications in the WTO dispute settlement rules. If the Review Commission found that there were three such improper WTO panel decisions in any five-year period, any Member of Congress could introduce a privileged resolution withdrawing Congressional approval of the WTO. This has been referred to as a "three strikes and we're out" provision.

Mr. Chairman, this legislation provides a balanced, flexible approach to the potential problem of improper WTO panel decisions. It is important to note that findings by the Review Commission will not by themselves cause any change in our status as a WTO member. Such a change could only occur after affirmative Congressional action, and only after the United States has exhausted attempts to negotiate corrective modifications to the WTO dispute settlement mechanism.

One of the primary benefits of this legislation is that it will help build a foundation of credibility for the WTO dispute settlement system. With the knowledge that independent and highly qualified U.S. judges will be reviewing their decisions, WTO panelists will have an incentive to more carefully follow and stay within their mandate. This is critical because the credibility of the entire dispute resolution system depends upon the willingness of WTO panelists to respect their roles and not encroach upon the sovereignty of members.

From the perspective of the business community, the best of all worlds would be for the Review Commission never to find that a WTO decision is improper. We want the dispute settlement system to work fairly so it can lay the groundwork for expanded world trade and a successful WTO.

By the same token, however, even one finding by the Review Commission that a WTO panel acted improperly would be a very serious matter. Given the enormous importance to U.S. businesses of an adverse WTO panel decision, it would be wholly improper for a panel to ignore its mandate. While the United States cannot expect to win every case, it can expect in every case to have a fair hearing and to have its sovereignty respected.

Three improper panel decisions in a five-year period would be totally unacceptable -- it would indicate that the dispute settlement system was not working properly and that U.S. sovereignty had been violated. More ominously, it would increase the possibilities that the United States might withdraw from the WTO and that the promise of expanded trade and economic growth would not be realized. With this in mind, foreign countries and panelists will certainly be less inclined to abuse the WTO system or to ignore the constraints placed on the WTO dispute settlement panels by the WTO agreements themselves.

The WTO Dispute Settlement Review Commission will help reassure American businesses and the American people that disputes under the WTO are being settled in an impartial manner and that American interests are being protected. Without a review mechanism such as that found in H.R. 1434, businesses adversely affected by WTO panel decisions would naturally question the appropriateness of these rulings. With the benefit of the WTO Dispute Settlement Review Commission, proper WTO panel decisions are less likely to be questioned.

One aspect of the Uruguay Round package that causes some apprehension is the shift to binding dispute settlement under the various WTO agreements. As the Members of this Committee can well remember, pre-Uruguay Round dispute panel decisions that strayed from the agreed GATT texts, or sought to add to the obligations accepted voluntarily by the United States at the negotiating table, could be blocked. Not only the implementation of such decisions, but their very entry into effect as a matter of international law could be avoided. Now, the results of the WTO's dispute resolution machinery are automatically adopted.

The WTO members agreed to reconsider this new approach after four years. This makes it critical that the United States have an effective, formal mechanism for evaluating decisions adverse to us to determine whether the new rules are adequately serving U.S. interests.

Some concerns have been raised about section 7 of H.R. 1434, which entitles private U.S. parties who support the U.S. Government's position, and who have a direct economic stake in a case, to participate in WTO panel proceedings. My personal experience and belief is that more openness could only improve the WTO panel process. Private parties have a great deal to add in terms of expertise and resources, and we should avail ourselves of these assets in the same way as our adversaries who routinely use the

full resources of private law firms and advisors in their WTO disputes. If, however, the presence of this provision would prevent the bill's passage or significantly delay consideration, we would be pleased to work with the Committee to find appropriate alternatives.

Questions have also been raised about the appropriateness of using judges from the federal judicial circuits as members of the Review Commission in light of their heavy caseloads. Mr. Chairman, I believe that the participation of federal appellate judges is vital to the success of the Review Commission. They are among the most distinguished jurists in the world and are uniquely qualified to carry out the type of reviews envisioned for the Review Commission. Unlike academics or private lawyers, they would be seen to have the neutral perspective necessary for this undertaking. Ensuring that U.S. sovereignty is preserved and respected is one of the most important functions in which federal jurists could engage. There are no appropriate substitutes.

Conclusion

From the perspective of AISI's U.S. members, it is still too early to assess fully the Uruguay Round agreements. We believe, however, that their success depends in large measure on the adoption of the WTO Dispute Settlement Review Commission Act, on the successful operation of U.S. trade laws and on improving those laws to make them more effective. We hope that as the Committee conducts its review, it will consider and adopt the recommendations we have made today.

Chairman CRANE. Thank you, Mr. Barnette.

I want to particularly express appreciation that you as chairman and chief executive officer were able to come personally before the Subcommittee, and we deeply appreciate that.

Jim, one of the key benefits of the automatic dispute settlement mechanism, in my mind at least, has been that it provides an incentive for disputing parties to reach an agreement before a WTO case proceeds too far, and I was just wondering if you have any idea how many potential disputes have been resolved successfully through consultations before reaching the litigation stage.

Mr. BACCHUS. That is an excellent point, Mr. Chairman, and for this reason: The purpose of the GATT is not to engage in litigation. The purpose of the GATT is to try to eliminate distortions to trade worldwide. So the preference is always that the parties resolve their dispute by eliminating whatever the trade distortion may be.

There have been a couple of dozen suits that have been filed in the first year of the WTO, but a number of them have now been resolved, and there are a number of other instances when through hearsay or other report, there are indications the mere existence of the system and the assurance the rules will be enforced has, in fact, brought parties to the negotiating table and caused them to enter into a resolution. That is very good news. That is a sign the system is working. That is evidence we were right to try for so long to get this type of a new dispute settlement system in the WTO, and it is certainly good news for the Appellate Body because that means we will have fewer cases to resolve.

Chairman CRANE. Very good.

Mr. Rangel.

Mr. RANGEL. Are you a judge or what? An Ambassador?

Mr. BACCHUS. You can still call me "Jim."

Mr. RANGEL. No, but, Jim, what is your formal international title?

Mr. BACCHUS. We are members of the Appellate Body, and I, for one, am accustomed to being called a member.

Mr. RANGEL. Tell me, do you sit in on cases and review cases that involved allegations of Americans violating international law?

Mr. BACCHUS. There is no prohibition on a national of any given country sitting on a case involving an appeal from that person's country. That is one of the rules that we have promulgated under our new working procedures.

That was a decision we had to make under the terms of the new Dispute Settlement Understanding.

There are seven members on the Appellate Body. I am the only one from the United States. There is a gentleman from Germany. There is a gentleman from Egypt. There are members from Uruguay, New Zealand, Japan, and the Philippines.

As you probably know, about half of the cases at any given point involve either the United States, the European Union, or both. Many of the cases involve multiple parties. So that, if we had a rule in which we had to recuse ourselves if our Nation was involved, it might be hard sometimes to assemble the three members that are required on a panel to hear any particular case.

In addition, our charge is to be independent and impartial, to try to enforce the rules to which the United States and the other mem-

ber nations of the WTO have agreed, and we concluded we could be independent and impartial in ruling on cases involving all nations, no matter where we might happen to be from as individuals.

Mr. RANGEL. I would assume sometimes the countries would not want justice, but just want to win. How would the Helms-Burton law, the bill that has just been signed into law, impact? You are not there to defend the United States. You are there for equity and fair play.

Mr. BACCHUS. I am from the United States, but I am appointed to this position by the World Trade Organization.

Mr. RANGEL. OK. Well, what impact would that law have on the WTO and/or when you are explaining what American law is and/or the ability to settle cases within a framework of friendship and understanding? What, if any, impact will the Helms-Burton law have upon your job?

Mr. BACCHUS. Mr. Rangel, that remains to be seen.

It is possible that that issue may come before the WTO and before the Appellate Body. If it does, one of the determinants of whether I would be permitted to sit in judgment on an appeal involving an issue would be what I might have said publicly in the past about the issue.

One of the issues that can be raised by a party to a dispute under the rules of conduct is statements that have been made by any of the members of the Appellate Body on an issue. An allegation might be made of a conflict of interest based on that particular issue.

So I have not made any statements, and it is not my intention to make any now, sir.

Mr. RANGEL. Thank you.

Chairman CRANE. Mr. Gibbons.

Mr. GIBBONS. What body of law, Mr. Bacchus, would your Appellate Body rely upon in deciding cases?

Mr. BACCHUS. The body of law on which we rely, Mr. Gibbons, is the GATT itself, especially in its current incarnation, in the trade agreements of the Uruguay Round.

As you certainly know, the Uruguay Round Trade Agreements incorporated GATT law dating back to the first days after World War II. Our charge on the Appellate Body when issues are brought before us is to deal only with issues of law and not with issues of fact. The facts are resolved at the panel level within the GATT at what is an equivalent to the trial court level in our terms of jurisprudence.

So we will be looking at the GATT law and trying to interpret it in a fair and evenhanded fashion. That is our charge. Of course, these agreements are all agreements on which the United States itself has agreed. These international rules of trade are rules that, in most instances, we Americans have sought and are, in every instance, rules to which we have agreed.

Mr. GIBBONS. Do private parties have any access to your organization, or must all actions be brought by government?

Mr. BACCHUS. Actions are brought by governments.

The litigation in the GATT is litigation between and among nations. The United States would bring an action itself. Mr. Kantor's office would take the lead in that.

Of course, in many instances, USTR is acting on behalf of private interests within the American economy.

There have been discussions in previous rounds of trade negotiations about permitting more private participation in the process. To date, not much of that has been permitted.

Mr. GIBBONS. You have got a wonderful challenge ahead of you. I know with your bright mind and your background, you will do well.

Mr. BACCHUS. You have trained me well, Sam. Thank you. I will do my best.

Mr. GIBBONS. Thank you very much.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

I would like to also thank Mr. Barnette for being with us today and testifying.

Mr. BARNETTE. Yes, sir.

Mr. PAYNE. Jim, welcome back. We are glad to have you back.

Chairman CRANE. Thank you.

Mr. PAYNE. You are a very capable and effective Member of Congress, and I know that you will perform in this new position equally well.

You are in a somewhat unique position in that you understand the system as it was before, and you have been involved in the system. You know a great deal now about the World Trade Organization as a result of what you are now involved in.

I would like to ask you if you would comment on the question of why you think American businesses and American workers feel good about the fact that we now have a World Trade Organization.

Mr. BACCHUS. We stand to profit more than anyone else in the world from a trading system in which there are rules that are agreed upon and enforced. More than anyone else, we need a reliable, predictable, stable, effective, efficient, enforceable world trading system, and most of all, we need one that is organized in a multilateral way in which rules are agreed upon multilaterally because, by multiplying the numbers of nations that are involved, we multiply the opportunities to lower trade barriers worldwide.

Why is that important to us? Because we have more goods and services to sell than any other nation in the world, and if barriers go down, that creates more opportunities for us than for anyone else.

Trade is not a favor that we do for another nation. Trade is something we do out of necessity for ourselves. We have chosen to use the GATT as our means of trying to open the doors of trade worldwide. We helped lead the world in the creation of the GATT, nearly 50 years ago, and we have led the way in transforming it, step by step, piece by piece, to the point where it is now truly a global world trade institution.

It began with 23 nations and covered just a small fraction of world trade. Now there are nearly 120 nations that are members, and they account for 90 percent of world trade.

Every nation in the world is either a member of the WTO or wants to be, and the WTO is an institution that is very much a reflection of our values as a nation. It reflects our values of freedom, free enterprise, and increasingly of due process and the rule-

driven, rule-oriented way in which we choose to do business and live our lives.

Because of this, we stand to provide from the development of the system. Generally speaking, we abide by the rules of trade. If we have a system in which the rules are enforced, we will profit more than anyone else, and moreover, because of what the Chairman mentioned a moment ago, if other nations know that the rules are going to be enforced, they will hesitate before engaging in unfair trade practices against us.

I was proud to serve my country in the Congress. I believe I am continuing to serve my country by trying to make this new system work for all the nations of the world because I believe if it works in a fair and evenhanded way for all the nations that are members of the WTO, then it will work, most of all, for us.

Mr. PAYNE. Thank you very much for that answer, and I wish you well in your new duties.

I would yield back the balance of my time.

Chairman CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. I will be brief.

I just wanted to say a special hello to our former colleague.

Mr. BACCHUS. Thank you. It is good to see you.

Mr. LEVIN. Welcome, and you are in a position where your talents will be very much used, as they were before.

Mr. BACCHUS. I remember when we worked together on the whip effort for the Uruguay Round.

Mr. LEVIN. Right. And I wanted to just talk with Mr. Barnette, briefly, about a couple of those provisions.

Mr. Barnette, I think that the steel industry is a vivid example of the importance of trade laws that very much recognize the globalization of trade, which has become a trite expression, and the need to combine it with strong trade laws that assure us of reciprocity.

And in this regard, I noted your comments about the review commission, and also your comments about the proposal for temporary duty suspension. And I just hope that all of my colleagues will have a chance to review your testimony and to remember we reviewed this issue, in great detail, and with great care, in the implementation language deliberations.

I personally think you make a very persuasive case. I think what we worked out was a good balance, and I hope we will not upset it.

So I hope you will persevere in trying to make sure all of us understand the importance of this for one of the fundamental economic links in our chain.

Mr. BARNETTE. Thank you, Mr. Levin. We certainly agree with your observations. Indeed, we believe it would, in effect, be a deterrent to the enforcement of our trade laws, were such legislation to be enacted. It could well set the clock back to the seventies, when the imposition of AD and CVD orders was indeed discretionary.

The legislation seems quite unnecessary. It has been dealt with effectively before, as you have made reference to, and we certainly will be prepared on any and all occasions to make our more detailed views on this subject known to the Subcommittee.

Mr. LEVIN. Fine. Thank you, Mr. Chairman.

Chairman CRANE. One final question I have, Mr. Barnette, of you, is many of our trading partners have been concerned the Dole Commission will allow the United States to find excuses to back away from our WTO commitments.

But on the other hand, it might work to keep the spotlight on the WTO, to make fair and defensible decisions.

Would you be comfortable with our trading partners having Dole-type commissions?

Mr. BARNETTE. Yes, Mr. Chairman. I think this commission is essential. I thank the leadership of Senator Dole in this matter. In discussions with the administration, as the Uruguay Round negotiations concluded, there was recognition that a balance is needed between trade liberalization and the national interest. We certainly want to move toward trade liberalization, but to preserve the integrity, the credibility, and the acceptability of WTO proceedings through the appellate process, we need to have in place in this country a commission such as the Dole Commission. I believe it is absolutely essential for the effective working of the WTO.

And we stand squarely behind the work of Congressmen Houghton and Levin here, and Minority Leader Dole in the Senate, in seeing that that commission is brought into law.

Chairman CRANE. Do you have any comments, Jim, on that?

Mr. BACCHUS. As I understand it, the Dole Commission is charged essentially with looking over the shoulder of the WTO and the Appellate Body, to make certain that in rendering its decisions it is abiding by the rules of trade, and enforcing the rules as they should be enforced. I have no problem with that.

It may prove to be helpful in reassuring Congress and the American people that the new dispute settlement system is working as it should. Our desire, on the Appellate Body, is to enforce the rules, and we intend to do precisely that.

Mr. BARNETTE. This is especially appropriate, I think, Mr. Chairman, when we look at the very limited function of the Dole Commission. The sole purpose will be to determine whether or not there has been an exceeding of authority, whether U.S. rights have been added to or diminished, whether there is arbitrary and capricious conduct, or deviation from a standard of review—something that, uniquely, U.S. judges are capable of rendering a decision and advice upon.

And then the Congress, solely the Congress would, of adverse finding, decide what if anything to do about it after three occasions—three strikes and we are out, as some refer to it—before there would be any further activity.

Chairman CRANE. Well, let me thank you both, again, for your testimony, and remind you your full statements will be made a part of the permanent record. I appreciate your being with us this afternoon.

Our next panel is Larry Clarkson, senior vice president for Planning and International Development with Boeing Co.; Timothy Elder, manager in Corporate government Affairs Division of Caterpillar; and Julie Hughes will be replacing Jack Listanowsky, and I am not sure what Julie's full title is, so I will wait and let her indicate as much. And Terence Stewart, managing partner of Stewart & Stewart, here, in Washington, DC.

Please, folks, have seats. And when you are ready, again, let me suggest if you can condense your presentations to 5 minutes, your full statements will be made a part of the permanent record, and we will go in the order I just listed.

Mr. Clarkson.

STATEMENT OF LARRY CLARKSON, SENIOR VICE PRESIDENT, PLANNING AND INTERNATIONAL DEVELOPMENT, BOEING CO.; ON BEHALF OF EMERGENCY COMMITTEE FOR AMERICAN TRADE

Mr. CLARKSON. Thank you, Mr. Chairman.

My name is Larry Clarkson and I am a senior vice president of Planning and International Development of the Boeing Co., but for Mr. Gibbons' benefit, I want to remind him I am a Gator.

I am appearing today on behalf of ECAT, the Emergency Committee for American Trade, whose membership includes the Boeing Co.

ECAT appreciates the opportunity to present its views to the Subcommittee on the implementation of the Uruguay Round Agreements and the World Trade Organization.

ECAT is an organization of the heads of leading U.S. firms, representing all major sectors of the U.S. economy. Their annual sales, worldwide, total over $1 trillion, and they employ approximately 5 million persons.

ECAT companies, along with their employees, have prospered under the global trading system developed under U.S. leadership over the past half century. It cannot be overstated that continuance of multilateral institutions on which it is based is of critical importance to the U.S. economy as a whole.

Mr. Chairman, I have prepared a written statement which I would like to have entered in the record, and I will just take a few minutes to summarize the points I have covered in that written testimony.

The U.S. economy and its workers have prospered under the global trading system developed under U.S. leadership, as I said.

It is essential this leadership not be undermined by critics of the global trading system and the WTO. The business community needs to respond to such critics by pointing out it is the United States itself that has championed the WTO and the global trade liberalization, and has seen the vast expansion of its economy as a result.

The multilateral trading system created after World War II has produced the longest sustained period of prosperity in the history of the world. Since World War II, tariffs have been cut by 85 percent and world trade has grown by 5,000 percent.

The creation of the World Trade Organization further strengthens the multilateral trade regime that has produced such trade liberalization by enhancing protection of U.S. commercial interests under strengthened dispute settlement rules, requiring all WTO members to adhere to virtually all WTO obligations, and requiring periodic reviews of the implementation of obligations by individual WTO member countries.

The global trading system and the WTO have benefited the U.S. economy and its workers. In 1995 U.S. exports displayed spectacu-

lar gains, and, as a result, the United States is once again the world's leading exporter.

The U.S. economy has been deemed to be the most competitive in the world by the World Economic Forum, rising from being fifth in 1992 to first in 1995.

This increase in U.S. exports has produced 880,000 new U.S. jobs in the last year, bringing the total U.S. jobs supported by exports to over 12 million.

Studies have demonstrated the U.S. firms with international operations have played a large role in maintaining U.S. competitiveness in world markets, increasing U.S. exports, and creating U.S. jobs.

Moreover, the jobs created by U.S. export firms are, on the average, higher paying, better jobs, than those created by U.S. non-exporting firms.

The first ministerial meeting of the WTO in Singapore this December will be a test of the effectiveness of the institution.

ECAT believes that in order to assure its success, implementation issues should be foremost on the agenda, and those new issues on which there is little international consensus should be downplayed.

ECAT also believes China's accession to WTO is a key issue which should be included in the ministerial agenda.

In the interests of strengthening U.S. leadership in the global trading system and further promoting its expansion, ECAT would also hope that efforts could be made to reach an agreement on the extension of the President's fast track authority.

Thank you very much.

[The prepared statement follows:]

TESTIMONY OF LARRY CLARKSON, SENIOR VICE PRESIDENT OF PLANNING AND INTERNATIONAL DEVELOPMENT, THE BOEING COMPANY ON BEHALF OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE BEFORE THE WAYS AND MEANS TRADE SUBCOMMITTEE OF THE U.S. HOUSE OF REPRESENTATIVES ON THE IMPLEMENTATION OF THE URUGUAY ROUND AGREEMENTS AND THE WORLD TRADE ORGANIZATION (WTO)

March 13, 1996

Mr. Chairman, my name is Larry Clarkson and I am Senior Vice President of Planning and International Development of The Boeing Company. I am appearing today on behalf of the Emergency Committee for American Trade whose membership includes The Boeing Company.

ECAT appreciates the opportunity to present its views to the Subcommittee on the implementation of the Uruguay Round Agreements and the World Trade Organization (WTO). ECAT is an organization of the heads of leading U.S. firms representing all major sectors of the U.S. economy. Their annual worldwide sales total over $1 trillion and they employ approximately 5 million persons. ECAT companies, along with their employees, have prospered under the global trading system developed under U.S. leadership over the past half century. It cannot be overstated that continuance of the multilateral institutions on which it is based is of critical importance to the U.S. economy as a whole.

Without U.S. leadership, global trade liberalization could be dramatically slowed. ECAT is concerned that public support for such U.S. leadership is being undermined by the rising criticism by some political figures of the WTO and trade expansion. It is essential that we in the business community forcefully respond to the arguments of critics who decry global trade institutions as a threat to U.S. sovereignty and employment by pointing out that it is the United States itself that has championed global trade liberalization since World War II and has seen the vast expansion of its economy as a result.

It is also vital that the United States exercise its leadership role to support the WTO's operation in a way that provides for its greatest success. To ECAT this entails promoting an agenda for the first Ministerial meeting which focuses on the implementation of agreements, and downplays the discussion of new issues on which there is little or no international consensus. It also means promoting the broadest possible membership in the WTO to encompass all major trading nations including China based on commercially meaningful protocols of accession.

Finally, the maintenance of U.S. global leadership will be furthered by the extension of the President's fast track negotiating authority. I would like to outline ECAT's views on each of these points.

I. Importance of the WTO to Global Trade Expansion

At a time when the economic benefits of the WTO and a liberalized trade regime are being challenged it is important to remind ourselves of the origin of that regime and the dire economic consequences that it was intended to remedy. Having endured the painful consequences of shutting off its markets under the disastrous Smoot-Hawley tariffs, the United States led the effort after World War II under the Bretton Woods Agreement to establish multilateral rules to promote global trade expansion through the creation of the General Agreement on Tariffs and Trade (GATT).

The multilateral trading system created after World War II has produced the longest sustained period of prosperity in the history of the world. Over the last 50 years, global tariffs have been cut by 85 percent and world trade has grown by more

than 5,000 percent. Under the Uruguay Round Agreements these benefits will continue to multiply.

The establishment of the WTO has further strengthened world trading rules and reinforced the institutional foundation of the world trading system in several ways. First, the WTO bolsters the multilateral dispute settlement system by creating a single dispute settlement body with tighter time deadlines that no longer allow countries found to be flouting the rules to block the adoption of panel reports. This stronger dispute settlement mechanism enhances the protection of U.S. commercial interests under the multilateral trading system. Second, by combining all the GATT and Uruguay Round Agreements under a single institutional framework under which members must adhere to virtually all GATT rules and trade agreements, countries will no longer be allowed to selectively adhere to GATT agreements, thereby enjoying a "free ride." Finally, the WTO formalizes the Trade Policy Review Mechanism (TPRM) which also will enhance compliance with WTO obligations since WTO member states know that their implementation of WTO obligations will be periodically reviewed.

The creation of the WTO framework itself is also an important addition to the institutional foundation of the multilateral trading system, as it finally transforms the GATT agreements into a permanent international institution on par with the World Bank and IMF.

While strengthening the multilateral system, the creation of the WTO in no way impinges on U.S. sovereignty. Compliance with the decisions of the WTO's dispute settlement body and indeed membership in the WTO itself are voluntary. It is up to the United States to decide whether it wishes to comply with an adverse WTO decision and whether to maintain its membership in the WTO.

Having outlined the key ways in which the WTO is vital to the multilateral trade regime, it is important to examine the ways in which it benefits the United States economy.

II. Benefits of an Open Global Trading System and the WTO to the U.S. Economy and its American Workers

The global trade expansion made possible under the GATT agreements and WTO has and will continue to produce substantial benefits to the U.S. economy and American workers. Trade now accounts for over one quarter of the value of what the United States produces.

As we have just finished the first year of implementation of the Uruguay Round Agreements, it is difficult to identify precisely their economic impact. However, the overwhelmingly positive U.S. export figures for 1995 indicate that the global trading system is yielding highly favorable results for the U.S. economy. Indeed, the United States has now regained its position as the world's largest exporter, surpassing Germany. The World Economic Forum in 1995 has deemed the U.S. economy to be the most competitive in the world for two years in a row, rising from being ranked in fifth place in 1992.

According to the just-released 1995 Department of Commerce trade figures, U.S. exports of merchandise increased by over $75 billion in 1995, for a total of $577 billion in annual exports, accounting for the largest export growth in U.S. history.

While the 1995 figures reveal that the U.S. trade deficit in goods and services increased by 4.5 percent in 1995 to $111 billion, this deficit in relation to the size of the U.S. economy is smaller than the deficits the U.S. experienced in the 1980's. In addition, due to the increasing global demand for U.S. goods and services, the deficit actually decreased over the last 6 months of 1995. Moreover, the U.S. trade deficit with Japan declined by 7 percent in 1995, reaching its lowest point in 12 years.

As a result of the spectacular growth in exports in 1995, some 880,000 new U.S. jobs were created, bringing the total of U.S. jobs supported by exports to 12 million.

In viewing the resurgence of U.S. competitiveness in world markets, it is important to understand the ways in which the success of U.S. firms with international operations has generated benefits to the U.S. economy. ECAT's 1993 study of the role of U.S. firms with overseas operations in the U.S. economy, "Mainstay II," documents the positive contributions made by such firms to the U.S. balance of payments throughout the 1980's and into the 1990's. In particular, the ECAT study found that American companies with overseas investments generated positive trade surpluses from 1984 through 1990 due to sharply rising U.S. exports in every industrial sector, that their overseas investments kept these American companies competitive, and that the growth in their exports generated increased employment for their U.S. workers.

Not only does U.S. export growth produce jobs but, according to a recently released joint report by the National Association of Manufacturers (NAM) and the Institute for International Economics (IIE), jobs created by exporting firms provide compensation which is on average 10 percent higher than that provided by non-exporting firms. The study also concludes that exporting firms are more productive and economically stable, and add jobs at a rate 20 percent faster than non-exporting firms.

The joint NAM-IIE report like the ECAT study, also contradicts the myth that U.S. direct foreign investment leads to a decline in U.S. exports and is harmful to the U.S. economy. The study notes in particular that even in sectors such as computer and aerospace which have large overseas investments, export sales are not decreasing.

Rather than losing in global competition, the trade statistics reveal that the United States is winning. Clearly, a strong set of multilateral trading rules, significant tariff reduction, and the elimination of non-tariff trade barriers have all played a large role in producing positive results for the U.S. economy.

III. Agenda for the December Ministerial Meeting

The first Ministerial which will be held this December in Singapore will be viewed as an initial test of the effectiveness of the WTO as an institution. ECAT believes that it is in the U.S. interest to have the first Ministerial be viewed as a success. In that spirit, ECAT believes that the agenda of the first meeting should emphasize those areas which will lead to expanded trade and investment and downplay those areas in which there is a lack of international consensus. To that end, ECAT believes that implementation issues should be foremost on the Ministerial agenda and that the WTO should hold itself and its members to the highest possible standard of implementation and compliance with WTO obligations. ECAT also believes that efforts should be made to secure commitments from WTO member countries, particularly developing countries, to accelerate their assumption of WTO obligations and tariff reductions.

In terms of unfinished negotiations, ECAT is of the view that the agenda should include a review of efforts to pursue greater market access and liberalization in services sectors such as financial services and telecommunications. The United States should continue to preserve its right to withhold MFN treatment in those service sectors where inadequate market access offers are made. ECAT also believes that the agenda should include efforts to broaden Uruguay Round market access commitments. For example, ECAT believes that the United States should continue to pursue the reciprocal elimination of duties in those sectors such as wood products, electronics, certain distilled spirits, and non-ferrous metals in which it was unable to obtain zero for zero tariff commitments in the Uruguay Round.

In the interests of promoting greater support for the WTO, ECAT is of the view that with regard to "new issues," the Ministerial agenda should place the greatest focus on those issues which have the best prospects for achieving some consensus within the WTO. The discussion of those issues which lack any international consensus such as labor should be downplayed in the agenda as they are unlikely to produce any positive results. Such issues may be better pursued in other international fora. Similarly, issues which are the subject of negotiations in other fora and on which no consensus has been finalized would not seem to be appropriate items for the agenda.

Although not a new issue to the WTO, ECAT believes that China's accession to the WTO on the basis of a commercially acceptable protocol should be included on the Ministerial agenda. In light of the critical economic and political importance of China in terms of bilateral relations and the multilateral trading system, it is essential to secure China's commitment to submit itself to WTO disciplines. China's accession to the WTO offers a unique opportunity to restructure U.S.-China trade in a direction that leads to a more stable and prosperous commercial relationship. However, China's accession to the WTO must be based on a commercially acceptable protocol that improves U.S. market access and implements WTO rules and obligations.

At the end of 1995, the United States presented the Chinese government with a "road map" outlining the commitments on market access, intellectual property, government procurement, services, and trade remedies that China would need to make in order for the United States to support China's WTO accession. The road map would allow China some flexibility to phase in its WTO obligations over time.

The Chinese government is very interested in obtaining WTO membership and has announced certain market access concessions including 30 percent tariff reductions on 4,000 items in order to further its accession efforts. However, until the full details of the concessions are published, their significance cannot be realistically evaluated.

ECAT believes that the inclusion of China's WTO accession as an item on the Ministerial agenda will promote greater progress on accession negotiations. While clearly China must agree to a commercially acceptable protocol of accession before it should be allowed entry into the WTO, once such a commitment is made the United States should be prepared to extend WTO benefits to China.

IV. Conclusion

ECAT believes that the United States must maintain its leadership role in supporting the WTO and in pushing for its continued expansion. Critics of the system must be reminded as well that the very system that they claim is encroaching on U.S. sovereignty and draining U.S. jobs, is the system that the United States itself has toiled over the last 50 years to create in order to best protect its economic interests. Despite any negative rhetoric, the system has worked to promote U.S. economic interests, has enabled U.S. exports to surge in world markets and has created better, higher-paying jobs for Americans.

As we look forward to the first WTO Ministerial in December, ECAT believes that the United States should bolster the credibility of the WTO by promoting an agenda which focuses on implementation, and downplays those new issues on which there is a lack of international consensus and little promise of eventual agreement. One issue of great importance which should be included in the agenda is China's accession to the WTO.

Finally, we would hope that efforts could be made to reach an agreement on the extension of the President's fast track negotiating authority, thereby promoting the continued expansion of the multilateral trading system.

Chairman CRANE. Gentlemen, I think what we might do is recess right now, because we cannot get all four of your testimonies in before this vote will be over. And we will take a momentary recess, run over there and vote, and run right back.

[Recess.]

Chairman CRANE. At this point, I would like to turn to Mr. Elder.

Mr. ELDER. Thank you, Mr. Chairman. I am here on behalf of Caterpillar and the National Foreign Trade Council.

Chairman CRANE. You live in Peoria, Mr. Elder?

Mr. ELDER. Yes, sir.

Chairman CRANE. You live in Peoria?

Mr. ELDER. Yes, I certainly do.

Chairman CRANE. Good man. [Laughter.]

Mr. ELDER. Actually, I am a Bradley graduate also.

Chairman CRANE. Oh, what year?

Mr. ELDER. 1971. So I missed you by a couple of years.

Chairman CRANE. Yes. I left there in 1967.

Mr. ELDER. Yes.

Chairman CRANE. A great experience.

I am sorry. Go on.

Mr. ELDER. That is quite all right.

STATEMENT OF TIMOTHY L. ELDER, MANAGER, CORPORATE GOVERNMENT AFFAIRS DIVISION, CATERPILLAR, INC.; ON BEHALF OF NATIONAL FOREIGN TRADE COUNCIL, INC.

Mr. ELDER. Thank you. I am Tim Elder. I am here on behalf of Caterpillar and NFTC, the National Foreign Trade Council, Inc.

Politicization of trade is obviously front and center today in the media, and from our standpoint, we believe that is unfortunate. It is creating an inaccurate and a misleading picture of the premier trade forum, the WTO.

The current debate ignores some very basic facts—the U.S. status as the world's large trader; the reliance of close to 30 percent of U.S. GDP on trade; and the 12 million U.S. jobs that are dependent on trade, just to name a few.

One Presidential contender has gone so far as to suggest America is a nation of "peasants with pitchforks." NFTC and Caterpillar disagree. We are not a nation of "peasants with pitchforks." In fact we are Americans with exports, and exports are obviously very important to companies like Caterpillar.

Trade is critical to our ability to employ American workers. Last year, Caterpillar's exports generated work for 51,000 U.S. Caterpillar employees and supplier jobs at our U.S. facilities.

Our exports are increasing, more than a 14-percent increase last year. In no small part, the results of the Uruguay Round are playing a very large role in our ability to increase this export growth, and the outlook in the future is even better.

Our negotiators, that is, our U.S. negotiators, beginning with Clayton Yeutter, pushed for zero tariffs on construction equipment in the most important overseas markets for our products.

That achievement is probably the most noticeable benefit of the Uruguay Round to Caterpillar.

The WTO has only been in effect for 1 year, so from our perspective it is really too soon to determine how well the various agreements are working. It is, however, a good time to take a long, hard look at the WTO, and we are certainly pleased that the Subcommittee is holding this important hearing.

Let me briefly touch on just some of NFTC's thoughts on what should be the United States major objectives for the WTO as we approach the December 1995 Singapore Ministerial.

First, the ministerial offers the United States and other major trading nations the opportunity to reaffirm their strong support for the WTO, and to display and demonstrate the major economic benefits from active engagement in this global trade regime.

Frankly, we at Caterpillar believe, as a country, and as a company, we need to do a better job of educating Americans about the benefits of the World Trade Organization and trade, particularly if we are to remain committed and active players.

Our second major goal for the WTO Singapore Ministerial should be to examine, and frankly assess, how well countries are implementing their WTO obligations, particularly with respect to accelerating the implementation process in key areas such as intellectual property.

With respect to the implementation of the agreement so far, the preliminary results appear to be promising, especially as they pertain to the dispute settlement process. The process seems to be leading to a prompt resolution of disputes through consultation and negotiation.

The United States also remains a leading initiator of the dispute settlement procedures as this country works to ensure our trading partners play by the rules of the game.

At the same time, we have to pay careful attention to our own WTO obligations and not intentionally invite dispute actions against ourselves. Over the long run, these type of actions could undermine public support for the WTO.

Another important area is to ensure that the 29 countries or territories seeking to join the WTO do so on solid commercial grounds, and those members agree to a standstill agreement on new trade restrictions. Both China and Russia are very important in this regard.

A third major area of focus for the Singapore Ministerial involves the built-in agenda of the WTO. One of the most critical issues on the immediate horizon is the deadline for a final services agreement on telecommunications.

Other critical built-in agenda items include negotiations on financial services, overall services, agriculture, and government procurement.

On the procurement issue, the NFTC strongly supports the efforts by the USTR to establish greater transparency and due process in government procurement markets, particularly for those countries that are not members or signatories to the government procurement code.

A fourth area where the Singapore Ministerial should make maximum headway is to reach agreement on additional tariff elimination.

In this regard, Caterpillar has particular standing. As I mentioned earlier, we were one of the prime beneficiaries of the Uruguay Round zero tariff accord, in our case, on construction equipment.

What has surprised us most, back in Peoria, is we thought we would get a real groundswell of enthusiasm for this agreement. What we have found, however, is that those sectors of Caterpillar's business that were not covered are pretty upset.

So, really, rather than getting patted on the back, we are getting kicked in the backside. Our engine business wants to know why they are not covered by this agreement, and in fact that is one of the challenges we would lay before this organization.

We need to expand the zero tariff initiative. It is good for American companies. It is particularly good for Caterpillar.

Last, there is discussion underway on a variety of new issues that might be addressed in one form or another at the ministerial.

They include competition policy, investment, foreign bribery and corruption, and the environment and labor.

While some of those issues may be ripe for WTO discussion or action, we have to make sure there is sufficient consensus before we raise them.

Returning to the United States, let me close by just commenting that providing new fast track authority as soon as possible is critical. It is essential to maintaining U.S. economic leadership and achieving an ambitious future trade negotiating agenda.

Finally, I would just like to say that in an ever-changing and uncertain world, quick fix solutions can have great political appeal, but contrary to the views of a few, we cannot succeed in the 21st century by adopting 19th century trade policy. Rather, we have to seize the opportunities presented by an expanding global marketplace and use the WTO as a foundation.

Thank you very much.

[The prepared statement follows:]

TESTIMONY OF TIMOTHY L. ELDER
MANAGER OF CORPORATE GOVERNMENT AFFAIRS DIVISION
CATERPILLAR INC.

ON BEHALF OF

NATIONAL FOREIGN TRADE COUNCIL, INC.

BEFORE

SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
HONORABLE PHILIP M. CRANE, ILLINOIS, CHAIRMAN

MARCH 13, 1996

Thank you, Mr. Chairman. I'm Tim Elder, Manager of the Corporate Governmental Affairs Division of Caterpillar Inc. I appreciate the opportunity to testify today on behalf of the National Foreign Trade Council (NFTC) on the important topic of the World Trade Organization (WTO). The NFTC applauds the leadership that you and others members of the Subcommittee have shown on this matter.

The National Foreign Trade Council is a broad-based trade association dealing exclusively with U.S. public policy affecting international trade and investment. The Council's membership consists of approximately 500 U.S. manufacturing companies, financial institutions and other firms having substantial international operations or interests. Our members collectively account for over 60 percent of all U.S. non-agricultural exports and a like percentage of all U.S. private foreign investment.

The Council's goal is to develop and advance policies designed to expand U.S. exports, enhance U.S. foreign investment and improve the global competitiveness of U.S. industry. Essential to achieving this goal is a strong and vibrant multilateral trading system that promotes open trade and investment in three vital ways by: (1) eliminating and reducing tariff and non-tariff barriers to international economic activity; (2) establishing predictable and equitable trade rules; and (3) providing mechanisms to ensure that the rules and agreements are upheld. By embracing these three objectives, the GATT and WTO have made an enormous contribution to worldwide economic growth for almost five decades.

Unfortunately, much of the current political controversy on trade presents an inaccurate and misleading picture of the WTO. It ignores the basic reality that the United States is the world's largest trader. It also fails to recognize that America stands to gain the most from an open international economic system which allows us to seek export opportunities in the world's fastest growing markets. The foes of freer trade dismiss the fact that nearly 30 percent of U.S. GDP and some 12 million U.S. jobs are supported by trade. They use trade as the scapegoat for all of America's problems, rather than educating Americans on why trade is part of the solution to future growth and prosperity here at home. Do we really want to view ourselves as a nation made up of "peasants with pitchforks," as one presidential contender has suggested? At the NFTC and Caterpillar, we view ourselves not as peasants with pitchforks, but as Americans with exports.

At Caterpillar, for example, trade is critical to our ability to employ American workers. Last year, Caterpillar's exports generated work for 51,000 employees at the company's U.S. plants and those of our U.S. suppliers. I am pleased to report that Caterpillar's exports are increasing -- by more than 14 percent last year. In no small measure, some of our export success can be attributed to the results of the Uruguay Round. U.S. negotiators were successful in negotiating "zero" tariffs on construction equipment in two dozen of our most important overseas markets.

The WTO has now been in force for just over one year. While it may be too soon to tell how well the various Uruguay Round agreements are working, it is a good time to begin serious reflection on this matter because of the upcoming first biennial WTO Ministerial Conference in Singapore this December. A successful Singapore Ministerial is critically important to the United States, and we should approach it with ambitious yet realistic expectations.

Reaffirmation of the Importance of the WTO

Given the inflammatory rhetoric currently surrounding the trade debate, the Singapore Ministerial offers the United States and other major trading nations the opportunity to reaffirm their strong support for the WTO. The United States should exert strong leadership in recognizing the importance of remaining actively engaged in an open trading system and should use the Singapore Ministerial to demonstrate the major economic benefits of the WTO. This is particularly important in light of the growing proliferation of bilateral and regional freer trade and investment initiatives. Reaffirmation of our commitment to the WTO should be our overall objective for the ministerial meeting.

Assessment of WTO Implementation

One of the top U.S. priorities for the Singapore Ministerial must be a frank assessment of how well countries are living up to their WTO obligations. This is no small task when one recognizes that there are 29 individual legal texts and 25 various ministerial declarations, decisions, and understandings, in addition to thousands of pages of WTO tariff commitments. The basic requirement for the WTO to reach its full potential is that all members implement the agreements and follow the rules. This is a Herculean task for our government, and it is essential that sufficient resources are provided to ensure that it is effectively accomplished.

Although it is premature to fully assess the record on implementation, I would like to comment briefly on a few issues relating to implementation of the WTO agreements that are important to NFTC members.

Dispute Settlement.-- Contrary to the fears about the impact of the WTO on U.S. sovereignty, particularly in the area of dispute settlement, the results are promising. The Singapore Ministerial will provide a good opportunity to look at the record more closely.

One of the major objectives of the new dispute settlement process is to encourage the prompt resolution of disputes through consultation and negotiation, and to use formal dispute settlement panels as a last resort. As of February, seven different disputes, affecting 19 different matters, have been settled without having to resort to formal dispute panel procedures. Moreover, the United States is initiating many of these cases. We have launched dispute settlement procedures to address a whole range of issues, including Japan's failure to provide 50 years of copyright protection for sound recordings under the WTO's intellectual property rights agreement -- the TRIPS Agreement -- and the European Union's beef hormone ban. We are using the dispute settlement process as it was intended -- to make sure our trading partners play by the rules of the game. The United States should aggressively use the dispute settlement mechanism to ensure that the WTO agreements are being faithfully implemented.

In order to promote an effective dispute settlement process, the United States should pay careful attention to its own WTO obligations. We should not intentionally invite WTO dispute settlement actions against the United States. To that end, adherence to WTO rules and agreements should be a primary factor of consideration when enacting major legislation. Failure to do so could eventually undermine U.S. support for the WTO. Just as we expect our trading partners to respect the rules of the game, so should we. Indeed, as an example, the NFTC has serious concerns with various pending legislative initiatives to impose unilateral economic sanctions.

Acceleration.-- Wherever possible, the United States should encourage accelerated implementation of key WTO agreements. The different WTO transitional periods prevent the United States from taking full advantage of anticipated WTO benefits. Shortening these transitional periods, such as those on intellectual property protection, is in everyone's self-

interest and would boost confidence and support for the WTO. There is much discussion in various regional groupings about freer trade and investment, and the Singapore Ministerial offers the best venue for putting actions behind these words of further trade liberalization.

Regional Initiatives.-- There has been a significant proliferation of bilateral and regional trade and investment initiatives. These efforts need to be consistent with WTO rules and should ultimately serve as building blocks and models for future multilateral liberalization. The NFTC views the recent establishment of a permanent WTO Committee on Regional Trading Arrangements as a positive step toward improved scrutiny of regional trade initiatives to ensure their WTO consistency. The WTO should be much more vigilant in this area.

Accessions.-- One testament to the importance of the WTO is the fact that there are some 29 countries or territories seeking to join the already 119-member strong organization. Major economies, including economies-in-transition, have applied for WTO membership. Not only is China in the process of joining, but also Russia, Ukraine and Saudi Arabia to name a few. The NFTC believes it is essential, in terms of U.S. economic interest and the overall future health of the global trading system, that countries accede to the WTO on sound commercial grounds. There should also be a standstill requirement for these countries to ensure that they do not impose new trade and investment restrictions. Russia's recent threat to ban U.S. poultry imports, as well as its reported actions on raising major tariffs, highlight the importance of a standstill requirement. Finally, it's time to start revising our cold war trade laws so that our relationship with all WTO countries is based on the fundamental pillars of the WTO, which means permanent MFN status for all WTO members. These issues deserve thoughtful consideration as we approach the Singapore Ministerial.

Built-In Agenda

Unlike past GATT Rounds, the Uruguay Round Agreements contain a full agenda of ongoing action items. There are numerous provisions calling for reviews, notifications and additional comprehensive negotiations. We have at least two important deadlines on the immediate horizon -- an April 30th deadline for concluding the services negotiation on basic telecommunications and a June deadline on a maritime services agreement. At this point, the telecommunications talks appear to be the most promising in terms of their potential to achieve meaningful market access liberalization in major overseas markets. Certain key countries, however, including several in Asia, have yet to make concrete market access offers. Such steps are central to the ultimate outcome of these talks.

There are many other major action items that are built into the WTO's future agenda, including further negotiations on financial services by the end of 1997, as well as broader talks on services by the year 2000. There is also a mandate for new negotiations on agriculture beginning in 1999, and a three-year work program to harmonize rules-of-origin. All of these issues should be negotiating priorities for the United States.

Another crucial area for future WTO negotiation pertains to the Government Procurement Code. The Code is one of the few agreements that is not part of the WTO's "single undertaking." As a result, only those countries that have signed the code are covered under its provisions. Korea was the only major new country to join the Government Procurement Code as part of the Uruguay Round talks. While the United States was successful in expanding the provisions of the Code, by extending coverage to subfederal entities and certain key service sectors, among other provisions, the Code's membership consists primarily of highly advanced countries. Consequently, it excludes from its disciplines the enormous government procurement markets in major developing countries. These markets are estimated to be worth over 1 trillion dollars in the coming years.

Ideally, the Code should be part of the WTO's single undertaking, rather than remaining as a "plurilateral agreement." This should be our long-term goal. In the meantime, Code membership should be a key part of any accession protocol for new members, and we should make progress in achieving interim steps toward full code membership. To that end, the NFTC supports the recent efforts of Ambassador Kantor to establish greater transparency and due process in government procurement markets for non-code countries. This would help address the

problem of foreign bribery and corruption practices, which erode the development of thriving market economies. We hope that substantial progress can be made in this area as part of the Singapore Ministerial.

In sum, a great deal of preparatory work must be done to achieve progress on the action items that are already built into the WTO's future agenda, and this should be a primary focus of the Singapore Ministerial.

Further Market Access

To the maximum extent possible, the United States should leverage ongoing discussions on market access in various regional fora for the purpose of reaching agreement on further tariff cuts at the Singapore Ministerial. The Administration retains residual authority to eliminate tariffs on key products, including electronics, non-ferrous metals and wood products. It also has authority to make changes to the chemical tariff harmonization agreement. We strongly encourage the Administration to seek multilateral agreement on further tariff cuts.

In this regard, I'd like to point out that Caterpillar has special standing. As stated earlier, the company was the primary beneficiary of the Uruguay Round's zero tariff accord on construction equipment. What has surprised me is rather than celebrating the elimination of tariffs on two-thirds of Caterpillar's production, I've been inundated by criticism from our managers who are responsible for the products not covered by zero tariffs. Rather than singing our praise, they want equal treatment for their products. And they want it as soon as possible! I'm beginning to appreciate what it must be like to be a congressman.

So for the record, Caterpillar urges WTO negotiators to make the elimination of tariffs on diesel and gas turbine engines a top priority.

New Issues

There is a great deal of discussion currently underway on a variety of new issues that might be addressed in one form or another at the Singapore Ministerial. These include initiating WTO activities on competition policy, investment, foreign bribery and corruption, labor and the environment. While some of these issues may be ripe for discussion or action, we should only move forward where there is sufficient consensus and preparatory work for doing so. The list of agenda items for the Singapore Ministerial is already long and we should not build up expectations too high as to what can or cannot be achieved at this first ministerial conference. We should also not expend our limited resources in areas that are at present deemed highly controversial in the context of the WTO. We are particularly concerned about broadening the WTO agenda to include a "social clause."

U.S. Leadership and the Need for Future Fast-Track Authority

Before concluding my testimony, I would like to express the strong support of the NFTC for congressional approval of new Fast-Track authority as soon as possible. We testified before the Subcommittee last year on our more specific views on new Fast-Track authority, and we look forward to working with members of the Subcommittee on this matter. It is essential to maintaining U.S. economic leadership and achieving an ambitious future trade negotiating agenda.

On a final note, I would just like to say that in an ever changing and uncertain world, we all know that quick fix solutions have great political appeal. But contrary to the views of Mr. Buchanan, we can't succeed in the 21st century by adopting 19th century trade policy. Rather, we should seize the opportunities presented by an expanding global marketplace, in which the WTO serves as its foundation.

Thank you very much for the opportunity to testify on behalf of the NFTC.

Chairman CRANE. Thank you, Mr. Elder. And now, Ms. Hughes. I am sure you are with Limited.

Ms. HUGHES. Actually, I am not with The Limited, although Mr. Listanowsky sends his regrets that he could not be here today. I am here as chairman of the U.S. Association of Importers of Textiles and Apparel, since on short notice, he could not make it to Washington.

Chairman CRANE. Well, we are grateful you made it.

Thank you.

STATEMENT OF JULIA K. HUGHES, CHAIRMAN, U.S. ASSOCIATION OF IMPORTERS OF TEXTILES AND APPAREL

Ms. HUGHES. Thank you. USA–ITA, the U.S. Association of Importers of Textiles and Apparel, is a national organization of more than 160 U.S. importers, apparel manufacturers, retailers, and related service companies.

These companies source apparel in the United States and all over the world. Collectively, our member companies account for more than $40 billion in U.S. sales annually, and employ approximately 1 million U.S. workers.

Overall, the U.S. apparel import and retail industries account for over 3 million jobs. USA–ITA strongly supported the Uruguay Round negotiations, and we support the World Trade Organization.

We are very pleased the Subcommittee is meeting today to review how the WTO is working. The elimination of barriers, I do not have to tell all of you, both domestically and overseas, is good for the economic well-being of the United States.

Our industry specifically sees special growth opportunities in the retail and in service sector initiatives under the WTO. But today, we want to talk a little bit about the implementation of the World Trade Organization over the past year, and specifically the Agreement on Textiles and Clothing.

As the Subcommittee knows, textiles and apparel are the most highly protected of all U.S. industries. Quotas on textile and apparel were established over 30 years ago as a temporary measure of protection to promote structural adjustment.

They have expanded into a pervasive system of protection. Currently, there are more than 2,000 quotas in place.

The WTO, though, created a process where over 10 years these quotas will be phased out. This lengthy transition was agreed to by all sides, so that our domestic industry would have time to adjust.

USA–ITA and our members are especially concerned because during the first year of the World Trade Organization, the Clinton administration took actions that actually tightened restrictions on textiles and clothing. I want to just cite four points from this past year.

First, the Clinton administration refused to increase the transparency of the decisionmaking process for textiles and apparel. Since Ambassador Kantor and the administration have publicly stated their support for greater transparency and public participation in the World Trade Organization, we were hopeful this would also apply to the textile sector.

However, CITA, the Committee for the Implementation of Textile Agreements, still holds secret meetings. There are no minutes of

these meetings to tell the public why decisions are made, and there is no public participation until after new quotas are announced.

USA–ITA believes it is essential that CITA should, at a minimum, release detailed summaries of their meetings. After all, even the Federal Reserve Board releases minutes 6 weeks after each meeting.

We also encourage the Members of the Trade Subcommittee to talk with the administration about having public meetings in advance of decisions being made.

USA–ITA believes the International Trade Commission would be the best place to hold these hearings. If that is not feasible, we would certainly support public hearings by the CITA agencies.

Second, the Clinton administration used the special safeguard mechanism in the Agreement on Textiles and Clothing to create new quotas and to undercut the goal of liberalizing textile quotas.

I believe this was discussed earlier this morning, Mr. Chairman. Last year, the United States initiated calls for 26 new quotas. That is 26 times the United States tried to restrain trade, 26 times we had opportunities we gave to our trading partners to potentially restrict their markets as well.

In effect what has happened is that now, in 1996, there are more quotas in place than we had at the beginning of the World Trade Organization.

Because of increased scrutiny by the Textiles Monitoring Body in Geneva, some of the United States calls were actually dropped. But we feel we are headed in the wrong direction. We are seeing more protection, and we feel this may encourage certain elements of the domestic industry to think they do not need to yet rationalize their business or take steps to prepare for the liberalization that will eventually occur.

Our third point is the integration process in textiles which was interpreted by the Clinton administration to mean that no products ever under quota would be removed from quota until the year 1998, at the earliest.

Essentially, the Clinton administration said all clothing was sensitive, so that T-shirts, jeans, sweaters, or blouses are not going to be removed from quotas until the end of the transition period.

Even the Congressional Research Service report said integration of the most sensitive items are all deferred until the end.

We think that does not make sense from a business perspective. A 10-year phaseout is one that should take place over 10 years, not one that happens only at the end of the 10 years.

Our fourth point is, in addition, the Clinton administration used the Uruguay Round to mandate a change in the rules of origin. We are not here to challenge that change in the rules, but we do want the Members of the Subcommittee to understand that in the implementation, the Clinton administration has not met the commitments they stated in the Statement of Administrative Action.

No rulings have been made public on how the rules of origin will be implemented. So while they go into effect on July 1, 1996, we do not know how to plan our business to comply with those rules.

So, in conclusion, while we are supportive of the WTO, we feel during the past year, the implementation has been mixed. The administration has not accepted the fact of liberalization in the textile sector.

As my colleagues have said, it is important for U.S. industries that we open up other markets and remove barriers to trade, and we hope the United States will set a better example.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Testimony of Julia K. Hughes, Chairman of the
UNITED STATES ASSOCIATION OF IMPORTERS OF
TEXTILES AND APPAREL

on THE IMPLEMENTATION OF THE WORLD TRADE ORGANIZATION

before the Trade Subcommittee of the
House Ways & Means Committee

March 13, 1996

Good morning. My name is Julia K. Hughes. I am the Divisional Vice President, Government Relations of the Associated Merchandising Corporation. I am testifying in my capacity as chairman of the United States Association of Importers of Textiles and Apparel (USA-ITA).

USA-ITA is a national organization of more than 160 U.S. importers, importer-manufacturers, and retailers of apparel, and related service companies. These companies source apparel throughout the world, as well as in the United States.

Collectively, member companies account for over $40 billion in U.S. sales annually and employ approximately one million U.S. workers. Overall, the U.S. apparel import and retail industries account for over three million jobs, more than twice the number of jobs in the textile and apparel manufacturing sectors combined.

USA-ITA strongly supported the Uruguay Round negotiations. And our members support the World Trade Organization (WTO). We are very pleased that the Trade Subcommittee is reviewing how the WTO is working.

The elimination of barriers to trade, both in the United States and abroad, is essential to America's economic well-being. Overseas trade barriers deprive U.S. businesses of opportunities to market U.S. goods and services. Our own industry sees significant growth opportunities overseas in retailing and supports the WTO initiatives to eliminate barriers to service trade and investment. In particular USA-ITA and our members are especially concerned about the implementation of the WTO's Agreement on Textiles and Clothing, known as the ATC.

As the Committee knows, textiles and apparel are the most highly protected of all U.S. industries. Quotas on textile and apparel imports originally were established over thirty years ago as a temporary measure to promote structural adjustment. They have expanded into a pervasive system of protection. Currently, there are more than 2,000 quotas in place -- affecting shipments from 47 countries. Quotas cover over 95 percent of all U.S. apparel imports and over 80 percent of all textile and apparel imports. Tariffs on these products are some of the highest in the Tariff Schedule -- averaging 18.3 percent for apparel alone.

The WTO created a process to eliminate special quota protection over ten years. This lengthy transition was agreed to so that all elements in the U.S. domestic textile industry would have time to adjust.

USA-ITA is concerned because during the first year of the WTO, the Clinton Administration took actions that actually tightened restrictions on textiles and apparel. I want to highlight four points:

1) The Clinton Administration has refused to increase the transparency of the decision-making process for textiles and apparel. Since Ambassador Kantor and the Clinton Administration have publicly stated support for greater transparency and public participation in the WTO, we were hopeful that this would apply to the textiles area as well.

However, the Committee for the Implementation of Textile Agreements (CITA) still holds secret meetings. There are no minutes of these meetings to tell the public why decisions are made. And there is no public participation until after new quotas have already been announced.

USA-ITA believes it is essential that CITA should at a minimum release detailed summaries of their meetings. After all, even the Federal Reserve Board releases this type of detailed summary six weeks after each meeting. We also urge the members of the Trade Subcommittee to encourage the Clinton Administration to adopt new procedures so that public meetings could be held in advance of decisions being made. This will improve the quality of CITA decisions and also will show that the U.S. is committed to treating textiles the same as other sectors. USA-ITA believes the International Trade Commission (ITC) would be an excellent place to hold these hearings. But if that's not feasible, we would support hearings by the CITA agencies.

2) The Clinton Administration has used the special safeguard mechanism to create new quotas and to undercut the goal of liberalizing textiles quotas. There are more quotas in effect today than there were at the beginning of the WTO.

Last year, the first year of the transition to normal trade rules for textiles, the U.S. initiated 28 calls for new quotas. That is 28 times the U.S. tried to restrain fair and open trade. Twenty-eight times that we opened ourselves to the charge of restricting access to our market. And 28 opportunities for our trading partners to restrict access to their markets. That is also more calls for quotas than the U.S. made in 1994, before the WTO was in effect.

Because of increased scrutiny by the Textiles Monitoring Body in Geneva of those new quota demands, however, the U.S. actually dropped a number of those requests. There are at least 16 more new quotas in place today than at the beginning of the Uruguay Round Agreement. Clearly, we are headed in the wrong direction. Instead of encouraging the domestic industry to take steps to rationalize or to increase their competitiveness by creating new products and seeking out new markets, the Administration is seeking to expand reliance upon the quota system. That is totally contrary to the spirit of the Uruguay Round.

3) The "integration" process of the ATC was interpreted by the Clinton Administration to mean that no products ever under quota would be removed before 1998. Eighty-nine percent of all apparel products will remain under quota until the end of the ten-year phase-out. As the Congressional Research Service stated in a recent report "integration of the most sensitive products will be deferred until the end."

So essentially, the Clinton Administration is telling us all clothing is sensitive -- t-shirts, jeans, sweaters, blouses, underwear, you name it. And this doesn't make sense. We might understand a determination that, say, certain sectors of the underwear industry are particularly sensitive. But to have our government say that practically all clothing is sensitive, that doesn't make sense. A ten-year phase -out is one that is supposed to take place over 10 years, not one that does not happen until the end of ten years.

4) In addition to the specifics of the ATC, the Clinton Administration used the passage of the Uruguay Round to mandate a change in the rules of origin for textiles. While USA-ITA and our members have accepted the fact that those rules will change, we think the members of the Trade Subcommittee need to know that the Clinton Administration has not met the commitments in the Statement of Administrative Action that would have given our industry time to adjust to these new rules.

Specific rulings from Customs are not yet available to the public. And the process of consultation with a trading partner is just beginning.

Since the new rules go into effect on July 1, 1996, we believe it is essential that the Clinton Administration establish a "grace period" or other mechanism to allow companies to make a smooth transition to these complex new regulations.

In conclusion, the first year of the World Trade Organization has been mixed when we review the textile area. The Clinton Administration has not seemed to accept the fact that gradual liberalization is required in the textile sector. As my colleagues on the panel have stated, U.S. industries need other countries to open their markets and remove barriers to trade. It's up to the U.S. to set a better example for the rest of the world by allowing protection to slow in the textile sector.

Thank you, Mr. Chairman and members of the Committee, for the opportunity to testify on these important issues.

Chairman CRANE. Thank you.
Mr. Stewart.

STATEMENT OF TERENCE P. STEWART, MANAGING PARTNER, STEWART & STEWART

Mr. STEWART. Thank you, Mr. Chairman. It is a pleasure to be here this afternoon.

I am here today on my own behalf, and the views I express are not those necessarily of any of our clients.

Looking at the success of the first year, one could say the WTO is off to a slow but hopefully encouraging start.

I want to focus on a few objectives that the United States had, and make some suggestions on ways in which those objectives could perhaps be more expeditiously accomplished in terms of greater transparency and greater participation by the public.

Transparency has been a major U.S. objective. It was included in most of the agreements, and the United States has fought hard in the first year of the WTO to try to have that implemented in the context of the WTO, with some success, but still minor success. I will just give a couple of examples.

A great deal of the information about how other countries' laws and regulations work are all notified under the WTO to various Committees. Those laws and regulations, even though public in foreign countries, remain restricted, by and large, and hence, not available to businesses, trade associations, or other groups here in the United States.

The United States has pushed hard to get that resolved. This Subcommittee may wish to ask the USTR which countries are holding up the process. As I understand, it is one or two, and those countries might be brought under increased pressure with other legislation that may be before this Subcommittee or Congress to try to see that a primary function; namely, the public has a better understanding that the rules and regulations of our trading partners are accomplished, so trade can in fact be expanded.

One area where that has worked reasonably well has been in dispute settlements where the USTR has been making available their briefs, has been making available public versions of other briefs, and has been encouraging public submissions of views, something I believe is very much to the benefit of the trading system.

A minor suggestion in that regard is that it is difficult to get documents from USTR simply because of the small public reading room. Those are the kinds of documents that could easily be put on the Internet, that would make them much more readily available to the public at large.

In certain areas, the United States is not getting the information, in my view, that is needed to be able to determine whether or not the agreements are being effectively implemented.

In safeguards, only six countries have come forward and identified any remaining safeguards, despite the fact that as recently as 1992, there was a list, I believe in excess of 300 safeguard measures, that were deemed to be "gray area" measures, that were supposedly on the books.

This Subcommittee might have an interest in asking USTR to compile the prior list, and to identify which of those, to their

knowledge, in fact have been discontinued, as that was a primary objective of the Safeguard Agreement.

A second thought on safeguards is the tradeoff for elimination of "gray area" measures is supposed to be a safeguard agreement that in fact works.

This Subcommittee should be deeply concerned with whether or not the Safeguard Agreement, and, for that matter, our implementing legislation, is in fact available to industries that are in distress. Recent history, in the United States, I would suggest, suggests it has not been effective, and if you do not have a way to deal with crises, you will not have a successful multilateral trading system.

Finally, with regard to an area like agriculture, the test, as in TRIPs, will be the extent to which the WTO self-polices, or the United States polices, because there are a lot of countries who have in fact not implemented their obligations as yet.

Part of that is technical assistance problems. Many developing and least developed countries do not have the technical wherewithal to implement on an expedited basis the obligations they have committed to.

The United States should be leaning on international organizations such as the World Bank, the IMF, and others, to try to see that funding is used first and foremost to help those countries both gain the benefits of international trade while at the same time honoring their obligations under international trade.

With regard to agriculture, with the long debates that have been going on on the Farm Bill, I would only say with the huge amount of export subsidies that exist in countries like the European Union, and elsewhere, Congress should be deeply concerned about unilateral disarmament.

Our farmers, in many sectors, will lose out if we cutoff the subsidies without getting commitments from our trading partners to scale back at the same time.

I see my time is up, Mr. Chairman.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF
TERENCE P. STEWART
MANAGING PARTNER, STEWART AND STEWART

BEFORE THE COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES

"Implementation of the Uruguay Round Agreements and Establishment of the World Trade Organization: A Review After Year One" (TR-18)

MARCH 13, 1996

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify today on the implementation of the Uruguay Round Agreements and the establishment of the World Trade Organization. As a practitioner here in Washington focusing on international trade and trade agreements, I have followed closely developments in Geneva for many years. What happens in Geneva can have important repurcussions on communities, companies and workers here in the United States. I offer the following testimony in my individual capacity. The views presented do not necessarily reflect the views of our firm's clients or of other members of the firm.

I. An Overview of the World Trade Organization's First Year

As the Committee is aware, the World Trade Organization was launched on January 1, 1995 as anticipated. In many ways, considering the difficulties inherent in the process and the list of tasks facing it, the WTO is off to a reasonably good start.

Considered from a "strict constructionist" perspective, the WTO membership could be faulted for accomplishing relatively little in the first year of the new organization, for moving slowly on a long list of procedural tasks, and for allowing themselves to liberally interpret various WTO codes and agreements based on their own internal concerns.

As in many other areas of law, however, a "rational review" standard is perhaps more appropriate. In particular, the WTO's accomplishments (or lack thereof) during its first year must be viewed in light of several other factors: the sheer amount and extent of what was agreed to in Marrakesh, the limited resources of many of the WTO members and of the WTO itself, and the institutional power struggles that accompany any major multilateral agreement. In addition, several basic organizational issues were still unresolved as of January 1995, which further limited the WTO's ability to move quickly from the outset. For example, the WTO had not yet appointed its Director-General, Renato Ruggiero, or the seven members of its standing Appellate Body. Similarly, the WTO headquarters agreement with the Swiss government had not yet been finalized at the outset of the WTO. The WTO has still not worked out revised arrangements for compensation and benefits for staff, a matter understandably impacting morale.

Given these obstacles and limitations and the extremely heavy workload facing the various committees and bodies, it is fair to conclude that the World Trade Organization's launch has thus far been a reasonable success.

II. Progress on Overall U.S. Objectives Under the WTO

One way to view the preceding 15 months and the current status of the WTO is by measuring its progress in particular areas of interest to the United States. Among these priorities are: increased transparency of Member countries' laws and regulations affecting trade, increased access to WTO processes and documents for non-governmental organizations (NGOs) and the private sector; and improved functioning of the individual WTO committees and Codes.

(A) Transparency

Increased transparency was an important goal of the United States during the Uruguay Round Negotiations. In all or nearly all agreements that were part of the Uruguay Round package, members agreed to provide information on laws, regulations and practices to the WTO, to establish contact points within the government for inquiries from other WTO members and, where appropriate, to improve the transparency and due process of administrative actions affecting international trade.

(1) Notifications

The WTO notification requirements, contained in almost all of the 1994 agreements, provide a primary basis for countries to challenge the differences between various national laws and the international agreements with which they are required to conform. Much can be said about how quickly the WTO has or has not gotten up and functioning by the timeliness and completeness of notifications to the WTO by member countries.

Various deficiencies in the notification process have become apparent during the WTO's first year. For example, many countries (including the United States) failed to meet the deadlines for submission of notifications in a variety of areas. In particular, notifications of government subsidy programs were untimely: only 21 countries had notified their subsidies to the Committee on Subsidies and Countervailing Measures as of last November. More than 40 Members had not yet made safeguards notifications by year-end, and only about one-third had made the required notifications on rules of origin.

Many countries have filed incomplete or insufficient notifications. Developing and least developed countries often require technical assistance that has been forthcoming too slowly or on too limited a basis to permit reasonably timely compliance. Because of these delays and deficiencies, the process of Committee review, questions and answers based on notifications and possible challenges based on these notifications has fallen behind the initial intended schedule.

Despite these limitations, the notification process is moving albeit more slowly than desired. WTO committees have received a large number of notifications in a variety of different areas:

- 50 notifications as to domestic safeguard legislation
- 56 notifications regarding antidumping legislation and regulations, and 54 notifications or communications regarding countervailing duty legislation.
- 55 notifications from WTO members specifying whether they wished to retain the right to use the transitional safeguard mechanism in Article 6 of the Agreement on Textiles and Clothing
- 26 notifications of trade-related investment measures (TRIMs), including a large number of measures involving the automotive sector.

The value of the notification process will be enhanced only if countries in fact supply complete information and are challenged both as to completeness and to conformity of laws, regulations and practice with WTO obligations. The question and answer process in the committees can significantly help countries identify potential problems with their current laws

and practices as well as identify potential controversies that may need to be addressed.

(2) Public access to documents and the process

Opening up the GATT process and making documents more readily available to the public has been a second element of the U.S. desire for greater transparency. The obscure nature of GATT processes and the restricted classification of most GATT documents (including copies of public laws that have been forwarded to a particular committee) has generated strong criticism from some groups in the United States in the past. While there has been significant effort expended by the United States to bring the issue of liberalized access to closure in the WTO during the first fourteen months of the WTO, there remains no final resolution. Thus, access to most documents remains restricted. The Committee should continue to encourage the Administration to keep resolution of this issue a top priority within the WTO. The Committee may wish to be briefed by the Administration on which of our trading partners are blocking progress on the issue so that other trade issues which may affect our trading partners can properly reflect a recognition of which countries are obstructing the objective of improved transparency.

Because industries, workers and communities have a critical interest in the proper functioning of the international trading system, the Committee should ensure that access to foreign government laws, regulations and practices are available for review and comment by the public at large. For example, the European Union submission on subsidies is apparently more than 1,000 pages in length. While most of what has been submitted may be known to many or most interested members of the public, there will be many who are unaware of the range of subsidy practices used abroad. The public availability of such submissions would improve the chances of WTO consistent practices being identified or raised in concrete disputes.

(B) Functioning of WTO Committees

With regard to the functioning of the various WTO committees and governing bodies, it is simply too soon to assess whether the new agreements have improved the efficiency and effectiveness of these groups. Because of the simultaneous existence of the WTO and GATT 1947 during 1995, there were certain administrative inefficiencies which should have ended with the end of GATT 1947 at the end of 1995. Similarly, the level of activity in some committees (most notably, the Committee on Anti-Dumping Practices and the Committee on Subsidies and Countervailing Measures) may have been reduced in 1995 because of transition rules which effectively reduced or eliminated the likelihood of disputes in 1995.

In some areas where substantive rights are at stake, some Members have reportedly not yet implemented their Uruguay Round commitments. For example, Director-General Renato Ruggiero stated in his first annual report that some WTO Members have not yet implemented their agricultural commitments. Obviously, delay in the implementation of substantive obligations denies other members important rights. Similarly, in areas like TRIMs and TRIPs, certain substantive provisions became effective in January 1996. As of January 1, 1996, several Members were reportedly not in compliance with these agreements, and the United States presumably will begin to pursue disputes in these areas, either through the WTO or through bilateral negotiations. The effectiveness of Committees will be measured in part by how quickly such shortcomings are identified and how quickly the WTO or individual members are able to bring members into compliance.

III. A Review of Specific WTO Agreements and Committees

A. Services

Over the past two decades, international trade in services has become a crucial component of the global economy as well as of many national economies (including the United States, where services account for approximately 70 percent of GNP). The Uruguay Round marked the first attempt to eliminate market barriers and distortions in a variety of service sectors. The GATS was a reasonable start although there were certain provisions where negotiations will be ongoing in 1996 or later (subsidies, safeguards and government procurement). Politically, it was not possible to conclude agreements on certain sectors important to the U.S. (offensively or defensively): including financial services, basic telecommunication services, maritime.

The inability to conclude services negotiations on the above sectors prior to the conclusion of the Uruguay Round has in some respects left the continuing negotiations without the obvious leverage for substantial market openings (although some efforts to team the four areas have been made). If financial services are an indication, at the end of the process, the U.S. may not be terribly pleased with the results.

In the financial services sector, 68 participants had made commitments by the end of the Uruguay Round, and another 29 of these offered improved access in the extended negotiations, which concluded in July 1995. However, the results of these negotiations were not acceptable to the United States, which withdrew an earlier commitment to grant MFN treatment on the basis of inadequate offers from certain major developing countries (including Indonesia, Thailand, South Korea, and Brazil). While a compromise was reached to keep the financial services package operational, negotiating one sector at a time poses significant hurdles to significant liberalization.

Negotiations on trade in basic telecommunications services are ongoing and scheduled for completion next month. About 30 Members are participating, with another 30 governments maintaining observer status. Participants began distributing drafts of their telecommunications offers last July, but only 14 offers have been presented to date. The U.S. delegate sharply criticized several WTO Members in December 1995 for failing to list their current telecommunications regimes as well as proposals for liberalizing them. Technological changes and the urgent needs of business around the world may make telecommunications one area where some meaningful progress may be made.

Finally, difficulties are also evident with the maritime services negotiations, a difficult area for many countries, including the United States. Only six governments have made conditional offers, and many of these simply restate their previous offers during the Uruguay Round. The issues of port access and use, port handling, and ocean shipping are among the items being discussed.

B. Trade and the Environment

The relationship between international trade and the environment generated a great deal of public interest prior to the conclusion of the Uruguay Round. The result was the Decision on Trade and Environment, which established the Committee on Trade and Environment and specified several priority issues for the committee's consideration. Since that time, the WTO has done a reasonable job of making available policy synopses of the Committee's work on the key trade-environment issues.

The new Committee on Trade and Environment (CTE) has

an initial agenda to examine nine issues. In 1995, the Committee progressed on three of these issues: (1) the relationship between WTO provisions and trade measures taken pursuant to multilateral environmental agreements; (2) eco-labeling and packaging requirements, and (3) the transparency of trade-related environmental measures (and environment-related trade measures). It is likely that there will be a proposal for action on at least these three issues by the Singapore Ministerial.

C. Standards/Technical Barriers to Trade

The area of standards and technical barriers to trade is particularly important for multinational companies. The Committee on Technical Barriers to Trade made some progress on procedural issues during 1995, establishing an agenda that may produce results in 1996.

The TBT Committee determined last July what information Members would be required to submit regarding technical barriers. Since then, various Members have begun to submit draft statements and notifications. In addition, the Committee is in the process of conducting its first review of the TBT Agreement, which will continue through June 1996. There have also been a series of challenges to technical barriers to trade under the dispute settlement procedures. Such challenges are likely to be a critical component in business's ability to secure the benefits of the WTO.

The United States also has pursued standards-related issues with individual countries or groups of countries, both on a bilateral basis and in the context of other multinational negotiations. Thus, standards harmonization is an objective within APEC and was part of the US-EU negotiations in Madrid last December.

D. Sanitary and Phytosanitary Measures

The Uruguay Round Agreement on Sanitary and Phytosanitary Measures requires that all sanitary and phytosanitary rules be based on scientific principles, and prohibits use of such rules as a trade barrier.

The TBT Committee has already met jointly with both the Trade and Environment Committee and the Committee on Sanitary and Phytosanitary Measures (SPS). As with other committees and bodies, the work of the SPS Committee in 1995 focused mainly on establishing the format and recommendations for required Member notifications. To assist members, the Committee identified several international standards and risk assessment methodologies which Members could use in the notification process.

Many countries use sanitary and phytosanitary measures as vehicles to restrict trade. At the same time SPS issues can often be highly emotional to nationals for non-trade reasons. The SPS agreement should help curb some of the abuses in the existing system. How quickly and how broadly the abuses are curbed will be the measure of whether the SPS Agreement has lived up to its potential.

E. Safeguards

Under Article XIX of GATT 1994, members may "escape" from their WTO obligations and impose import restraints in certain circumstances where imports have caused serious injury or are threatening such injury. The Safeguards Agreement entered into force in January 1995. As discussed earlier, the notification process since that time has produced mixed results: about 50 Members have notified or communicated with the Committee regarding their domestic legislation in this area. However, by the end of 1995 more than 40 Members had

failed to make the required notifications under Article 12.6 of the Agreement.

During the Uruguay Round, the GATT Secretariat compiled an extensive list of so-called "grey area" measures, largely "voluntary" restraint agreements or voluntary export restraints. The Safeguards Agreement required notification of all grey area measures to the Committee or their immediate termination. To date only six Members (including the European Union) have provided a notification. While it is possible that all other countries have terminated all preexisting grey area measures, it is unlikely. The Committee may wish to obtain a list of preexisting grey area measures and a review by USTR of whether there is independent information of the termination of measures not notified to the WTO.

A word of caution is appropriate about the new Safeguard Agreement. Grey area measures presumably arose in part because of a perceived difficulty in using Article XIX and a political need to address an underlying trade problem. If Article XIX of GATT 1994 proves to be incapable of providing a trade remedy in many situations where "grey area" measures have been taken in the past, one can expect a breakdown in the use of the sytem, with increased use of unilateral trade measures by the United States and other countries.

F. Dispute Settlement

The WTO provided several important changes as to how disputes are to be handled compared with GATT practices and procedures. The WTO itself has described the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) as the "new teeth of the World Trade Organization." By all accounts, it is too soon to tell whether this statement is true, or whether dispute resolution is still largely a defanged entity.

The Understanding's great level of detail (including 27 sections, 143 paragraphs and four appendixes) attempted to resolve the problems that characterized at least some disputes under the GATT 1947. Lack of strict timetables, the need for consensus, and the possibility of forum shopping were some of the perceived problems of the old system. New features of WTO dispute resolution as outlined in the DSU include:

- the establishment of a single Dispute Settlement Body to deal in a unified manner with disputes arising from any agreements contained in the Final Act.

- the requirement of negative consensus (i.e., the need for a consensus against the establishment of panels or the adoption of panel reports, as opposed to the requirement of consensus under GATT 1947.

- the introduction of an appellate structure. Under the WTO, appeals may be taken by parties to the dispute, not third parties, and are limited to issues of law and legal interpretation by the panel. Where an appeal is taken, the Appellate Body report must be adopted and accepted by the parties, unless there is a consensus not to adopt the report.

The result is a WTO dispute settlement process that has attempted to streamline, clarify, and build credibility in the available remedies. In 1995, these procedures appeared to work reasonably well. The DSB was notified of 25 requests for consultations; the United States was a complainant in six of these cases and the object of the complaint in four more (reformulated and conventional gasoline, import duties on Japanese automobiles, and quantitative restrictions on

underwear). Nine dispute settlement panels were established in 1995. Settlements were announced (or apparent settlements reached) on seven of the 25 disputes.

In 1995, there were several early indications of improvement to the system. The strict timetables have already led to earlier resolution of some cases, and the number of settlements (seven) is an encouraging sign that dispute settlement will continue to be an effort to arrive at mutually agreeable solutions between governments as opposed to an overly litigious system of constructions of obligations being imposed by panels or the appellate body.

However, it is still too early to draw definite conclusions about the functioning of the system. The first dispute settlement ruling, announced on January 17, 1996, ruled against U.S. standards for reformulated and conventional gasoline. The United States has appealed the panel ruling to the Appellate Body. A number of other highly significant cases, such as the U.S.-European Union dispute over the EU's ban on hormone-treated beef, will provide crucial early tests of the new system.

In terms of number of disputes, there were fewer requests for consultation and fewer panels established in 1995 than in 1994. However, the number of developing countries participating in the dispute settlement process increased in 1995. In any event, the new system has not been "flooded" with dispute requests, as some critics feared. The total caseload may increase in 1996 and later years as the remainder of WTO rules, procedures and obligations take full effect and as the WTO's track record on disputes becomes established. For example, because of transition rules, no challenges were brought to national construction of the antidumping or subsidies agreements.

The United States insisted on clarification of the standard and scope of review for at least certain disputes. It is too early to say whether the U.S. government, business or labor will be satisfied with WTO actions on this score. The bill introduced in the Senate by Senator Dole to create a special Commission to review adverse panel decisions against the U.S., if enacted, would be helpful to this Committee and the public at large in gaining confidence that our international obligations are being construed in a reasonable manner by WTO panelists.

One area where there has been some affirmative movement has been the area of improved access to information about disputes and opportunity to provide written comments. USTR now solicits views from the public on pending cases involving the United States. Various groups including bar associations have submitted views in one or more actions in 1995. Similarly, USTR is making briefs (or public versions of briefs) and panel reports available to the public quite promptly. This system seems to be working reasonably well. The Committee may wish to explore whether such documents and comments received by USTR couldn't be made available to the public via internet to expand the audience and reduce the need to have a Washington presence or queue for available time at the USTR reading room.

G. Rules of Origin

The Uruguay Round's Agreement on Rules of Origin began a three-year program which will attempt to harmonize global rules of origin. Most of the technical work is being undertaken by the World Customs Organization (formerly the Customs Cooperation Council) in Brussels. The Harmonization Work Programme will once again dominate the agenda of the Committee on Rules of Origin this year and through 1997. A WTO technical committee submitted its report on the first phase of this program in November 1995. All WTO members are required to

notify existing rules of origin to the WTO, including both preferential and non-preferential rules. Only about one-third of the Members did so in 1995. The information received by the WTO has not be derestricted yet and is not available to the business community in the United States. Nor are any documents being generated by the WCO technical process. The Committee should urge the Administration to obtain derestriction of any documents not so treated at the present time and to make them publicly available as early as possible.

Rules of origin represent an area of critical importance for U.S. business, but one that is often overlooked. The United States has made a concerted effort to involve the private sector in the process of establishing these rules, but there remains a need for greater public awareness and participation in the process.

The International Trade Commission opened an investigation at the request of USTR and has sought input on an ongoing basis since that time. Review of its draft rules for various sections of the Harmonized Tariff Schedule will continue throughout 1996. The House Ways and Means Trade Subcommittee is also preparing legislative guidelines for negotiating harmonized WTO rules.

The rules of origin process in Brussels and Geneva has already raised several important issues, including whether a term such as "country" would be defined in a way that would permit Hong Kong to be treated as not part of China under trade remedy laws after 1997. This issue was not flagged for public comment and was largely unknown to most businesses and even many active trade practitioners. There needs to be a better mechanism for the public to access the ongoing negotiations to prevent surprises which may have very substantial consequences in the marketplace.

H. Preshipment Inspection

In 1995, there were several reports of trade problems associated with preshipment inspection company practices in selected developing countries. The WTO Agreement on Preshipment Inspection entered into force in January 1995, but was not effective in its first year due to the lack of an independent body to consider challenges, as specified in Article 4 of the Agreement. The independent entity, now established, will hopefully encourage more active enforcement of the Agreement in 1996.

As is true in other areas, WTO Members have only begun the notification process in PSI. Article 5 of the PSI Agreement requires Members to submit copies of all laws and regulations enacting the Agreement, as well as any other preshipment investigation laws and regulations. Only 11 Members had made such notifications by the end of 1995.

I. Textiles and Apparel

The Agreement on Textiles and Clothing (ATC) entered into force in 1995, signaling a complex, 10-year transition from the Multifiber Agreement (MFA).

In 1995, Members were required to integrate certain products from the list in the Annex of the Agreement. In addition, all but four WTO Members (Canada, the EC, Norway, and the United States) were required to notify whether they wished to retain the right to use the transitional safeguard mechanism contained in Article 6 of the Agreement. The TMB received 55 notifications, nearly all from countries retaining the transitional safeguard. Another 35 countries provided lists of products to be integrated into GATT 1994, as required for all countries retaining the transitional safeguard.

In 1995, the U.S. was subject to a large number of

disputes brought to the Textiles Monitoring Body, with respect to imports of certain products from one or more WTO Members. Ten unresolved cases were referred to the TMB for review, while several others were settled or withdrawn.

The initial decisions of the Textiles Monitoring Body have not been particularly helpful to U.S. administrators or industry in understanding the real basis for decisions by the TMB. In the years of transition from the MFA, guidance from the Textiles Monitoring Body will lose credibility if its decisions do not appear to follow a consistent standard that permits countries to take actions when appropriate. The early performance of the Body, while perhaps only a temporary problem, deserves the close attention of the Committee.

J. Agriculture

The Committee on Agriculture also spent much of 1995 establishing procedures for the body and overseeing the notification process. However, this area is complicated by the difficulty some Members are having in implementing their Uruguay Round commitments. This problem will create more serious concerns in the coming year, as Members who have fully implemented their commitments lose agricultural trade benefits with respect to those countries whose commitments are not yet implemented.

Notifications were first required in the area of tariff and other quota commitments, and will be extended to cover domestic support and export subsidies in 1996. In addition, the Committee will take further action on the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries.

An issue not directly related to the WTO's first year of existence but important to the functioning of the agriculture agreement is whether the United States will engage in unilateral subsidy reductions where European and other major agricultural exporters maintain export and domestic subsidies authorized by the agreement and schedules of commitments filed in Marrakesh. As the Committee is aware, the agriculture agreement did not eliminate export subsidies or major domestic subsidies. Many U.S. products face extraordinary hurdles in terms of export and domestic subsidies enjoyed by their foreign competitors. While the Congress and Administration have an interest in obtaining further reductions in subsidies in future negotiations, Congress should not complicate the future for domestic farmers by unilaterally reducing farm supports where there have not been similar additional reduction commitments from the European Union and other countries. Because agriculture was largely unregulated by the GATT, individual nations as well as the European Union have developed complex systems of agricultural regulations and import barriers. For example, total transfers from consumers and taxpayers to farmers in the OECD countries were approximately $300 billion in 1990, according to one study. At this time, these subsidies meant that income transfers and support prices accounted for 68% of farm income in Japan, 48% in the EU countries, 41% in Canada, and 30% in the United States.

The size of foreign agricultural programs poses a clear dilemma for the United States. Congress has been considering significant changes to the U.S. farm program, including reform and eventual phase-out of government subsidies. Such changes may be necessary due to federal budget constraints and would be rational in a free and open global agricultural market. However, if these subsidy reductions are made in isolation, they can easily jeopardize U.S. agriculture - not as a result of competitive pressure, but as a result of foreign government subsidies that artificially support agricultural programs abroad. Any U.S. decision to reduce its own subsidies without comparable reductions abroad would

effectively constitute "unilateral disarmament" in this crucial sector of trade. The Committee should do what is possible to see that any reductions in farm assistance in the U.S. are tied to multilateral agreements for further subsidy reductions abroad.

IV. Accessions

One of the WTO's primary challenges in 1995 and again in 1996 is the management of the accession process for 28 governments currently seeking entry, including China, the Russian Federation, the Ukraine, Vietnam, and Bulgaria. Although the WTO and some of these governments made significant technical progress, it is fair to say that the system is currently overwhelmed by the number of countries seeking accession and the complexity of the accession process due to the increased coverage of the WTO.

The difficulties of the accession process are perhaps unavoidable in some respects. Many of the countries seeking accession are making the transition from centrally planned to market-based economies, which significantly complicates the process. The economic and political significance of China, the Russian Federation, and the Ukraine also adds to the complexity of the proceedings for these countries. Finally, while WTO coverage now includes a range of new issues (TRIPS, agriculture, services), this increased workload is in many cases being managed in Geneva by smaller staffs at many foreign missions, which were reduced (as was the U.S. staff in Geneva) following the conclusion of the Uruguay Round.

The United States, European Union, Canada and Japan, among other countries, have made funds available for technical assistance to these countries. Such help is obviously important if the process is to proceed reasonably expeditiously. If anything, Congress should consider expanding USTR and other staff and providing for a temporary staff increase at the WTO to facilitate moving the accession process ahead (where appropriate) more quickly. The technical assistance provided to the various countries seeking accession could also be reviewed, along with ways that the private sector could improve the integration of some of these countries into world commerce on a more expedient basis. Moreover, the basic concept of achieving a "good commercial deal" for the United States is also sound policy. If there is a caution, it would be that for those countries which do not presently pose a significant commercial risk to the United States, there is some risk in making the price of membership for countries still struggling through declining GDP so high as to be unaffordable or, if affordable, only at the risk of needing to violate agreements shortly after they are entered into.

V. Conclusions

1995 was not a glamorous year for the WTO. It had some important successes -- the name of a Director-General, appointment of an appellate body (which has recently released its rules), starting the process of notifications required by the agreements, and a reasonably quiet dispute settlement scene with continued apparent resort to compromise more often than possibly viewed as likely by some just a year ago. At the same time, many of the U.S. objectives remain to be implemented. Congressional oversight is an important part of the process of helping the international system work as promised.

I would be pleased to answer questions or address issues about this year's Singapore's Ministerial and possible agenda items if of interest.

Thank you for the opportunity to appear.

Chairman CRANE. Thank you.

Mr. Elder, in your full testimony, you indicated the list of items on the agenda for the Singapore Ministerial is excessive. I was wondering what limited issues, at least, you'd throw out the window, for sure, that are on the agenda for consideration right now?

Mr. ELDER. I am afraid I would not touch that one with a 10-foot pole. I think the priority, as we approach the Singapore Ministerial, has to be to look at what is best for the growing sectors of the U.S. economy. And that is what we have tried to focus on—those companies within the National Foreign Trade Council membership that are truly outward looking, and looking to develop their capabilities on a worldwide basis.

I would come back to Caterpillar again, and say the number one priority for us is expanding zero tariffs on a worldwide basis, and we believe this agreement was a good deal for the United States.

We traded 2.5 percent tariff protection in the United States, and were able to get access to markets, where, up to that point, we were facing as much as 11 percent tariffs.

Chairman CRANE. Mr. Clarkson, do you have any thoughts on that?

Mr. CLARKSON. Only that we would like to see further progress made in the area of the subsidies code, and if I can put my Boeing hat on for a moment, the aircraft code.

Chairman CRANE. And one other question for you, Mr. Elder.

Many have criticized the Uruguay Round for being a negotiation that was unwieldy, too long, and too complicated. I am wondering if it is too early to anticipate how you might expect trade negotiations to go in the future?

Mr. ELDER. I guess, reflecting back on former Ambassador Yeutter's comments, as we stay engaged with our trading partners on the issue of trade, we find areas of agreement, and we believe that's a positive.

As we continue to talk to our trading partners, we find more amicable ways of resolving disputes. The seven major disputes that have arisen in the last year, which have been amicably resolved, the three which are before panel discussions now, I think are a strong indication of that. We need to keep talking.

Chairman CRANE. All right.

Mr. Rangel.

Mr. RANGEL. Do any of you have any views on the Helms-Burton Act that recently has been signed into law, as it relates to the issues you are trying to get on international trading fronts, and look at?

Or is that something we do not talk about?

Mr. ELDER. Well, we would step to the fore, but let me talk more on Caterpillar's behalf from the National Foreign Trade Council, simply because we have not really had time to reflect on it.

We have seen the impact of unilateral trade sanctions at my company, going back to the Soviet pipeline embargo beginning in 1978.

We saw how this country ceded markets with very little response, or very little reaction, from the target of those sanctions.

We always would encourage the Congress to go very slowly when it imposes unilateral sanctions, and we also would encourage very

slow movement when we are talking about secondary boycotts, the United States and my company having been the object of a secondary boycott called the Arab boycott, several years ago.

We do not believe that that is the way to conduct international trade, and we are very concerned about it undercutting the World Trade Organization that we have all taken so much time to create.

Mr. RANGEL. I supported it on South Africa, and it worked.

Mr. CLARKSON. That was multilateral.

Mr. ELDER. That is the difference.

Mr. RANGEL. What is it?

Mr. CLARKSON. It was multilateral.

Mr. RANGEL. I know that, but——

Mr. CLARKSON. And the trouble with the bill you are speaking of is it is unilateral, and it is not supported by our trading partners.

Mr. RANGEL. Did we hear from the business sector at all when this was being negotiated? I do not recall reading anything at all. There were murders that took place by a Communist dictator, and unnecessarily shooting people out of the sky, and all of a sudden the bad bill went good, and I just do not understand how people who spend so much time trying to improve the relationship between the United States and our trading partners could have our trading policy guided by the heroic actions of some people that disagreed with our foreign policy with Cuba.

There are certain things I have found, that it is extremely unpopular even to have a view on, and more recently, I think this has been one of the things people just would rather not talk about. That is OK, though. I pass.

Mr. ELDER. It is clearly not an issue we are reluctant to talk about, and if our message on what we consider the ill-advisedness of unilateral sanctions has not come through, perhaps we need to talk louder.

But as I say, we have been the victim of unilateral sanctions and of secondary boycotts.

Mr. RANGEL. Who are we, Mr. Elder?

Mr. ELDER. I am talking about Caterpillar at this point.

Mr. RANGEL. Forget Caterpillar. I am talking about the business community that relies on trade. We have a lot of people that——

Mr. ELDER. Mr. Rangel, I have 51,000 jobs dependent on trade.

Mr. RANGEL. I did not mean forget Caterpillar as an important industry. I just meant I could understand, that if you got up every morning, condemning the embargo in Cuba, it would not get the attention that you and I think it would need.

But it would seem to me the policy is broader than Caterpillar, and, indeed, broader than Cuba. It has to do with our respect for other nations. It has to do with not having them believe the only way to trade is the way we say, especially when it is based on our domestic problems and not our foreign problems.

So I just thought on the principle, that we would find the business community, who cannot afford the luxury in counting the electoral votes in Florida, and would decide that this is important for our country, for our trading policy. So when I go to those people and say I have been treated unfairly, we can go then to our friends, our trading partners, and tell them these things.

But I would be embarrassed to talk about freeing this inequity given how we have to treat them for something they did not do. I did not mean Caterpillar. But you might want to send me what you have said, though.

Mr. ELDER. OK.

Mr. RANGEL. Thank you.

Chairman CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and I want to thank all of this panel for their testimony. It has been very helpful, and I do appreciate it.

I want to take my time, because Ms. Hughes has brought up a subject that is of great interest to me and the folks I represent, and that has to do with textile and apparel, and trade, a very effective job of describing the views of the industry that is very active in importing apparel and textiles.

The United States has one of the most open textile and apparel markets in the world. The imported products now account for about one-half of all of the textile and apparel products sold in this country.

Opening overseas markets is where we need to go in this industry, just as in other industries, and I do applaud USTR for the work they are doing in that area, because as Mickey Kantor has told us today, 96 out of every 100 customers in the world are somewhere outside the United States.

During the Uruguay Round, the textile industry lost more than any other single industry. The industry had attempted to have a 15-year phaseout of the MFA Agreement. It failed to do so. There is a 10-year phaseout that we are now a little more than 1 year into.

So there are less than 9 years left in this phaseout period.

The textile and apparel industry has suffered. The industry, now, in terms of its employment, is the lowest its been since 1939. More than 140,000 textile apparel jobs disappeared just last year, in 1995.

I would like to address the issues, specifically transparency, that Ms. Hughes raised. The United States has published a quota phaseout list. It does meet the Uruguay Round obligations, and the U.S. actions on integration demonstrate a commitment to transparency that far exceeds what we are required to do in the Uruguay Round.

It was first published as a proposed list. Comments were solicited. Public hearings were held. Then after these steps, to gather as much information as possible, this final list was published.

The final list puts the U.S. commitment to the MFA phaseout on the table, and the reason this was published was the domestic industry and the importers asked the administration to do this.

One of our trading partners, as I understand, has done the same thing. Now that this final list has been published, it will take an act of Congress to make any changes in any substantive way.

You talked a little bit about new quotas under the safeguard measures. It was anticipated there would be safeguard measures taken during the phaseout period.

The safeguard measures cannot be new quotas, because it says in the Uruguay Round that safeguard measures cannot reduce any country's quotas below the average of the preceding 12 months.

They do not affect the growth-on-growth provisions of the Uruguay Round.

The Uruguay Round did not intend for the phaseout period to be the means by which trade in sensitive textile products was liberalized, and I think there is testimony to that effect by Ron Sorini, who was the textile negotiator in the Bush administration.

The implementation. During the consideration of this matter by the Ways and Means Committee, there was a rule of origin that was passed by this Committee. It subsequently became law. There was information at that time that there would need to be some time in order for the industry, the retail industry who was purchasing apparel overseas, to respond, and consequently, the time at which this was to take effect was to have been July 1, 1995.

However, it was extended to July 1, 1996, as we took that up. The proposed rule was published a little over 1 year ago, in May 1995, and then it was finally promulgated in September 1995 which is 10 months before the rule's effective date.

So there has been time for the importers to prepare for these new textile and apparel rules of origin. Customs has followed every relevant procedure, as I can determine, to make public the new rule of origin.

Customs has said it will issue a letter ruling to clarify any particular questions as to how this rule will operate.

Only 33 requests so far have been made to Customs. Most of those have come in the last month or so, and Customs, in my findings, has done its job, and the importing community must make the effort to contact Customs to clarify whatever these outstanding questions are.

I think we have all worked on this Subcommittee to try to do the right thing for all of our parties, including those people who work in the textile and apparel industry. The industry I think is doing the right thing, in terms of not asking for quotas to be extended, but, rather, looking at new opportunities and ways it can be successful, knowing that this 10-year phaseout will occur in less than 9 years.

I think what we all need to do is find a way that we can make sure, as Ambassador Kantor said today, the rules in the meantime are adhered to, and that the phaseout period be used as best as possible by all concerned, so that this adjustment will be one that will minimize, and we can find a way to mitigate the impact, particularly on employment.

I apologize for taking all of my time to say this. I thought it was important to say that, get it into the record, and I do appreciate your comments, your views, and would like to work together in the future, if there is some way we can find to do that.

Thank you, Mr. Chairman.

Chairman CRANE. Ms. Hughes, do you want to respond, briefly?

Ms. HUGHES. Yes, briefly. We do not need to debate this. I think the bottom line is that based on a 5-minute testimony, we could not go through many of the points you raise in terms of the timetable, and things that we have done to work together.

But I want to say that our association and our members are very much pushing the transparency issue. We agree with you that if the textile industry in the United States works with its customers, the retailers, and those companies who do import, we will have a better transition period than if we fight through these next 10 years.

So we feel it is very important that this issue has as much public discussion as possible.

Chairman CRANE. We thank you all for participation today, and please keep the channels of communication open.

Mr. Clarkson.

Mr. CLARKSON. Yes. I just want to put in the record that relative to Mr. Rangel's question, ECAT did in fact file comments on the Helms-Burton bill, and will be happy to supply those comments to this Subcommittee.

Thank you very much.

Chairman CRANE. Thank you, sir.

Mr. RANGEL. I appreciate the fact—I do not want to single you out, though. Like you said, Mr. Elder, it is something that really does not work in our best interests, and it makes it a lot easier for this not to become a partisan issue, if our businesspeople, from a nonpartisan view, as to just what is best for our business best interests, would speak out. Because it takes less courage for you to do it than for someone to believe that you are politically motivated in what you say.

So there should be groups that would say that, even in solidarity—do not mention Cuba, do not mention airplanes—as you are taking your time to help us with our thinking, to tell us what you think about certain policies we are following.

Of course we will listen to you and do what we think is in our best political interest, but still, if enough of you show it is not in our best political interest to do these things, it helps make it a better country and a better policy.

Thank you.

Mr. CLARKSON. We look forward to future opportunities to do just that.

Thanks.

Chairman CRANE. Thank you all.

Our next panel consists of Jeffrey Schott, senior fellow, Institute for International Economics; Dr. I.M. Destler, director of the Center for International and Security Studies at the University of Maryland; Joe Cobb, Olin Senior Fellow, Heritage Foundation; and JayEtta Hecker, Associate Director, International Relations and Trade, U.S. General Accounting Office.

If you folks will be seated. And we will commence with you, Mr. Schott.

STATEMENT OF JEFFREY J. SCHOTT, SENIOR FELLOW, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. SCHOTT. Thank you very much, Mr. Chairman.

I appreciate the opportunity to come before the Subcommittee today. My statement draws heavily on my previous experience as a U.S. trade negotiator, and also on my analysis of U.S. trade pol-

icy over the last 25 years, including an analysis of the Uruguay Round and the WTO.

I can be brief today because the distinguished witnesses you have called before this Subcommittee have done an excellent job in describing what the WTO is, and is not.

My statement, which I submit for the record, goes into great detail on the issues of sovereignty and voting rights, and dispute settlement, which have been covered very fully by Ambassadors Kantor and Yeutter, and the other witnesses, in response to your questions.

And so I will gloss over most of that part of my testimony, but simply to add one point that was not made clearly enough.

And that is that the WTO is not New World government. Indeed, as Ambassador Yeutter said, in most respects, it is just like the old GATT. It represents the culmination of over 50 years of U.S. efforts to liberalize trade and to establish a body of world trading rules, that conforms to, in many respects is modeled after U.S. trade law and regulations. It is our rules being brought forward to the rest of the world, and of course that is what we want to do in many new issues that are not yet subject to WTO disciplines.

Now, so far, I think, despite a rather bumpy start because of a dispute over the leadership of the WTO, the WTO has done pretty well. And I should add that despite that bumpy start on the leadership, or because of that bumpy start, one could say that Mr. Ruggiero, the director-general of the WTO, has bent over backward to prove his U.S. critics wrong. And he has done a good job, to date.

But it is not enough to rest on our laurels, and say we have done a good job in the Uruguay Round, and so far, so good. We have said that after each round of GATT negotiations, and then settled back and done very little to move the trade agenda and U.S. interests forward.

And each time that lapse has led to a regeneration of protectionist pressures, and new attempts to roll back the reforms just negotiated.

For that reason, the first WTO ministerial in Singapore is especially important, and must do more than a housekeeping chore of catching up on what is going on in the WTO.

Indeed, like the Seattle and the Miami summits, that established the rationale and the vision for long-run trade initiatives in the Asia-Pacific and the Western hemisphere, the Singapore Ministerial needs to develop work programs to guide members of the trading system as they approach the 21st century, so that the WTO can adapt to the new challenges arising from increasing globalization of economic activity.

And many of the concerns raised by Members of this Subcommittee certainly need to be reflected in the ongoing work program of the WTO in the future.

It is important the Singapore Ministerial get off to a good start, and move the agenda of the world trading system forward.

It needs to have some actions, because actions speak louder than words in this business, and there has to be some concrete results coming out of Singapore. To that end, I think several specific initiatives should be undertaken at the Singapore Ministerial.

First, WTO members need to rededicate themselves to the full and rapid implementation of the Uruguay Round accords, and, indeed, the acceleration of that implementation as we've already committed to in the APEC context.

Second, we need to extend trade concessions undertaken in regional trade initiatives like the APEC to all countries through new reciprocal multilateral negotiations, and we have an opportunity to do that because the APEC Ministerial, and summit, is just 2 weeks before the Singapore meeting, and one can have a declaration on the WTO, much like we in Seattle, which helped conclude the Uruguay Round in 1993.

Third, I think we need to start immediately on WTO negotiations on investment, which I would place as the number one priority of the new issues, although much more needs to be done on financial services, and other issues as well.

Fourth, the government procurement negotiations should be negotiated, not just for the reasons put forward by Ambassador Kantor, but because government procurement really can be the stepping stone toward new WTO disciplines on anticorruption, because that is a hotbed of anticorruption in foreign markets.

I think all of these aspects and initiatives can be undertaken immediately, without the recourse for the passage of fast track authority this year, but it would be desirable to have fast track soon after, in 1997.

I think the proposals put forward from this Subcommittee last year provide a very good basis for the type of compromise that you have called for, that Mr. Gibbons wants to consider, and I think it is in the U.S interest to push for a compromise to get fast track.

We need it to continue our export-oriented trade strategy, and we need it so that U.S. negotiators can get the best deal possible for U.S. trading interests.

Thank you very much, sir.

[The prepared statement follows:]

THE WORLD TRADING SYSTEM:
CURRENT PERFORMANCE AND FUTURE CHALLENGES

Statement by

Jeffrey J. Schott
Senior Fellow
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before the

Subcommittee on Trade
House Ways and Means Committee

March 13, 1996

The Agreement establishing the World Trade Organization (WTO) entered into force on January 1, 1995. As the world's most important trading power, the United States has a great stake in the success of WTO efforts to break down trade barriers around the world and to implement the trading rules promoting free and nondiscriminatory access to foreign markets negotiated in prior negotiations.

My testimony today examines the WTO and how it supports US trading interests, its record to date (including dispute settlement), and the challenges facing the trading system as WTO members prepare for the upcoming trade ministerial meeting in Singapore in December 1996. The statement draws heavily on my analysis of the results of the most recent multilateral trade negotiations, The Uruguay Round: An Assessment, published by the Institute for International Economics in late 1994, as well as my experience as a US trade negotiator in the Tokyo Round of GATT trade talks.

The WTO in Brief

The WTO represents the culmination of 50 years of efforts to liberalize trade and to establish a body of world trading rules that conforms to (and in many respects is modeled after) US trade law and regulations. In many respects, the "new" trading institution is very much like the "old" GATT (General Agreement on Tariffs and Trade) regime that has governed world trade since the late 1940s. The main difference is that the WTO provides greater legal coherence among its wide-ranging rights and obligations, and establishes a permanent forum for consultations and negotiations on an ever-broadening agenda of issues affecting global trade and investment in goods and services.

The most significant aspect of the WTO Agreement is its ''single undertaking'': member countries must adhere not only to GATT rules but (with a few exceptions) to the broad range of trade pacts that have been negotiated under GATT auspices during the past two decades. This ''single undertaking'' does not require much of countries like the United States that already adhere to almost all the existing pacts, but it ends the free ride of many GATT members that benefited from, but refused to join, new agreements negotiated in the GATT since the 1970s. Many countries, especially developing countries, have had to undertake substantial new trade obligations that they had not accepted in previous GATT rounds.

As of March 1, 1996, the WTO has 119 members and more than 30 other countries are in the process of acceding to the organization. WTO rights and obligations govern trade between signatories, but do not necessarily apply to trade with nonmember countries.

WTO Dispute Settlement

Trading rules have little value unless they can be enforced. For that reason, the effectiveness of the dispute settlement mechanism (DSM) is critical to the success of the WTO.[1]

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[1] A summary of the WTO dispute settlement mechanism is provided in the Annex to this statement.

In a sense, the DSM provides a warranty that the bill of goods sold to a participant during a trade negotiation will be dutifully delivered; in most instances, cases can be brought only when the rights and obligations undertaken in a previous negotiation are circumvented. If prior negotiations failed to produce new rights and obligations regarding an issue under dispute, then WTO dispute panels will have no basis for ruling on the conformity of that issue with WTO obligations.

Disputes often arise over issues that fall in the gray areas of multilateral trade obligations. In these cases, panels are asked, in effect, to resolve problems that were left hanging or untouched by prior negotiations. While expert panels could develop compromise solutions to pending disputes in such instances, there is understandable resistance to adopt an approach in which panels could change or expand the interpretation of WTO provisions and thus alter the negotiated balance of concessions.

In other words, WTO procedures do not involve a case-law approach to decisionmaking that allows panelists to interpret and build on precedents of past cases. To put it bluntly, nobody wants panelists to "negotiate" new WTO rules through their deliberations.

In those cases where disputes involve trade-distorting practices not covered by multilateral provisions, the WTO does not forbid unilateral measures by countries seeking to restore a "level playing field." However, such retaliation would have to be limited to actions that are not otherwise constrained by WTO obligations. In short, while unilateral actions (such as those taken pursuant to US Section 301) are not proscribed per se, the expanded scope and coverage of WTO rights and obligations severely limits the instances and types of actions that can be taken unilaterally without running afoul of WTO rules.

Interestingly, the Dispute Settlement Understanding (DSU) does not require the renunciation of, or even major modifications, in US section 301. The United States can continue to use section 301 as in the past; indeed, its use will likely be more GATT-consistent since the authority to retaliate will be almost automatically granted by the WTO.

Does the WTO usurp US sovereignty?

International trade agreements confer rights to the United States regarding the actions of other governments and impose obligations regarding our own actions. Some critics charge that such pacts infringe upon US sovereignty, seemingly oblivious to the fact that we enter these pacts because they are mutually beneficial bargains that strengthen US interests in world markets.

In the case of the WTO, concerns about US sovereignty primarily involve two issues: whether the United States will be forced to change its laws at the behest of WTO decisions, and whether majority voting by WTO members will rewrite the trade rules to the disadvantage of major trading powers. The answer in both cases is no.

Simply put, WTO decisions are not self-executing in US law. If a US practice is found to violate US international obligations, the WTO cannot force changes in US law or regulations. In such event, the United States can decide to bring its practices in compliance with its trade obligations, or affected WTO members have the right to demand compensation (which would most likely require congressional action) or to retaliate.

Contrary to the claims of WTO critics, there is little risk that economic pressure will be brought to bear on the United States to conform to WTO rulings if the Congress does not believe it to be in the US interest to do so. Few countries ever retaliate against the United States, because such action imposes costs on their own producers and consumers and sours relations with the world's largest trading nation.

Can the United States be outvoted in the WTO?

As under the GATT, WTO decisions will normally be made by consensus (i.e., decisions become effective if no member officially objects). If a consensus cannot be reached, matters will be decided by majority vote.

Although the one-country, one-vote rule has been standard GATT practice since 1948, concerns have been raised regarding the WTO's unweighted voting procedures. The one-country, one-vote procedure has provoked fears that ''majority'' decisions would discriminate against the major trading nations and undercut their sovereignty. Unflattering comparisons have been made between WTO procedures and the unweighted majority voting system of the UN General Assembly, and charges have been leveled that the unweighted voting system poses the risk of a ''tyranny of the majority.''

In almost every respect, these concerns are more theoretical than real. The GATT almost always acted by consensus (thus affording a big-power veto). In the few instances in which votes were taken, they did not exhibit UN-style block voting, even though the GATT operated under an unweighted voting rule. In addition, important checks and balances were added to the WTO voting rules that effectively institute a ''big power'' block on all but the most mundane WTO decisions and preclude majority votes from undercutting the rights of other participants.

Does the WTO "work"?

A critical test of the new World Trade Organization (WTO) will be its ability to oversee the implementation of the agreements negotiated in the Uruguay Round, to monitor compliance by WTO signatories, and to resolve disputes objectively and expeditiously. To date, the WTO generally has been performing these tasks quite well, despite its tight budget and thin staff.[2]

All the Uruguay Round accords are now up and running. In most instances, liberalization commitments have been fulfilled; the requisite domestic programs and practices have been notified; and the new trading rules have been or are being implemented through changes in national law or regulation. In addition, negotiations on liberalization of financial services, basic telecommunications, and maritime services have been restarted but -- like most sectoral talks -- have produced or will likely yield a meager harvest.

To be sure, some countries have tried to "fudge" the calculation of their required reduction of import barriers, particularly in agriculture; others have let notification deadlines slip. In a few cases, serious abuses have prompted disputes that are now being handled by the new WTO dispute settlement mechanism.

Contrary to the concerns of some GATT critics, the WTO dispute settlement mechanism has gotten off to a good start. In its first fourteen months, the WTO dispute mechanism has handled about 30 requests for consultations. The United States has directly challenged foreign practices in eight cases (involving the European Union, Japan, Korea, and Australia) and has joined plaintiffs in other disputes as an interested third party. Several of these cases already have been settled favorably; the rest are subject to continuing consultations or panel review.

Three cases have been brought concerning US practices, including a reaffirmation of a previous GATT finding that an EPA regulation on reformulated gasoline is applied in a discriminatory fashion and thus violates WTO obligations. This ruling was not surprising, since the United States implicitly admitted the violation and attempted to negotiate a settlement with Venezuela (rejected by the Congress) a few years ago. USTR has appealed the panel ruling but has an extremely weak case.

The United States benefits significantly from a WTO dispute settlement system that clearly, credibly, and objectively exposes wrongdoing and promotes the full implementation of WTO obligations. We should avoid bringing cases to the WTO for political reasons that do not have substantive merit, nor should we expect every ruling to condone US practice.

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[2] The WTO staff is small compared with that of the World Bank, the International Monetary Fund, the OECD, and other international organizations. The WTO budget is less than half that of the OECD or the International Labor Office. The US annual contribution to the WTO is only a quarter of that committed to the OECD and the ILO, and the same as provided to the UNCTAD.

In sum, despite a bumpy start which included a divisive dispute over leadership of the body, the WTO has made substantial progress in administering the Uruguay Round agreements. But that is not enough. While the Uruguay Round accords strengthened the multilateral trading rules and the WTO dispute settlement mechanism, some provisions remain vague or incomplete and some public policies remain outside the purview of the WTO system. To strengthen global trade relations, the WTO must continually adapt its rights and obligations to keep pace with the changing nature and expanding scope of global trade in goods and services.

To do so, WTO member countries need to work together to establish a new WTO agenda to deal with the trade issues of the 21st century. The first meeting of trade ministers in Singapore in December 1996 is the place to start.

The Singapore Ministerial

Meetings of the world's trade ministers have been few and far between. Under the WTO, however, ministers will gather every two years to direct the work of the trading system. Such regular sessions were designed to avoid past problems caused by delays in organizing meetings of ministers, launching new initiatives, and implementing the results of recently concluded negotiations. Such delays invariably led to the regeneration of protectionist pressures after each GATT round and new attempts to roll back the reforms just negotiated.

For this reason, the first ministerial meeting is especially important and must do more than play a housekeeping role. To preempt a protectionist backlash, and to keep the ''bicycle'' of trade liberalization upright and moving forward, the Singapore Ministerial must provide a venue for both a retrospective and prospective look at the new trading system. WTO members need to ensure that the trading system continues to adapt to the new challenges arising from the increasing globalization of economic activity.

Actions speak louder than words: Singapore must produce some concrete results. Several specific initiatives should be undertaken at the Singapore:

o First, WTO members should rededicate themselves to the full and rapid implementation of the Uruguay Round accords, and then some! Since the United States and other countries have already agreed in the APEC context to accelerate their Uruguay Round liberalization, we should ask no less of other WTO members -- particularly the European Union. Governments should follow the 50 percent rule advocated by the APEC eminent persons group: all tariff cuts should be implemented in half the time committed, and transition periods for the full implementation of WTO rules should be cut in half as well.

o Second, WTO members should commit to extending trade concessions undertaken in their regional trade arrangements to all countries through new reciprocal multilateral negotiations. To that end, the United States should support efforts at the next APEC summit in Subic Bay to submit a proposal in Singapore two weeks later linking APEC and WTO initiatives to help jump-start WTO talks (just as a similar APEC declaration on the Uruguay Round issued at the Seattle summit contributed to the successful conclusion of those negotiations in December 1993).

o Third, WTO members should start work immediately on comprehensive investment rules to discipline the carrots and sticks that countries deploy to coerce industries to invest in their markets. The TRIMs agreement in the Uruguay Round provided a tentative first step in this regard, but much more needs to be done. For example, WTO provisions do not adequately address investment incentives and establishment restrictions. WTO members should draw on efforts in other fora -- including current talks in the OECD and investment accords under development in regional arrangements -- to inform their work in this area. In that regard, the NAFTA provisions on investment provide many useful precedents for prospective WTO negotiations.

o Fourth, the WTO should accelerate the launch date of new negotiations on government procurement. Few countries adhere to

the WTO accord in this area (which is one of four pacts that do not require universal membership). Government procurement is an area where the United States both benefit in two ways: US firms could potentially reap major trade gains if they were able to bid on foreign government contracts in major developing country markets; and foreign compliance with WTO standards would expose and hopefully constrain corruption in the letting of those contracts. Indeed, government procurement talks could be an important steppingstone to future anti-corruption initiatives in the WTO.

In sum, countries need to rededicate themselves to the remaining problems and to undertake new trade initiatives promptly. To reinforce the credibility of the WTO commitments, countries should offer tangible evidence that they are willing to honor and expand upon liberalization commitments made in the Uruguay Round.

Furthermore, much like the Seattle and Miami Summits established the rationale and vision for long-run trade initiatives in the Asia-Pacific and Western Hemisphere regions respectively, the Singapore Ministerial needs to develop work programs to guide members of the trading system as they approach the 21st century. The goal should be the eventual elimination of tariffs and other border restrictions by a fixed date. Many of the world's major trading nations already have done this in the context of regional initiatives, so the WTO could become the forum for melding together the regional pacts into a coherent multilateral package.

US Fast Track Negotiating Authority

The United States does not need fast track authority to launch the initiatives suggested above for the Singapore Ministerial. Recall that we negotiated for two years in the Uruguay Round until fast track authority was renewed. The key requirement to make this work is close consultation and cooperation between the Administration and the Congress so that there is bipartisan agreement that these initiatives promote US interests.

Nonetheless, new efforts should then be made in early 1997 to develop fast track legislation. In my view, and that of many objective trade analysts, the fast track proposal put forward by the leaders of this committee last year comprised a reasonable and responsible compromise. There are two reasons why this should be done promptly in 1997. First, the United States needs to continue its export-oriented trade policy, which has served us well for the past decade and without which we would run the increased risk of a protectionist backlash given record US trade deficits. Second, fast track provisions enable US negotiators to work out the best deal possible since US trading partners will not need to hold back concessions for fear that the Congress will reopen and increase US demands after the talks are completed.

Conclusion

Let me conclude with two general thoughts on the WTO and US trading interests.

First, the WTO agreements create important trading opportunities for a broad range of US industrial and agricultural producers, but they do not guarantee success. To take advantage of the increased access to foreign markets, US firms need to maintain a competitive edge by investing wisely in physical and human capital and by producing more efficiently.

Second, while we pursue regional trade initiatives with our major trading partners in the Asia-Pacific, Western Hemisphere, and Europe, we should remember that multilateral trade negotiations in the WTO provide the biggest bang for the buck. Simply put, US trade reforms ''buy'' reciprocal commitments from the more than 120 members of the WTO. Bilateral or regional free trade pacts may complement the WTO results and indeed achieve deeper cuts in trade barriers in a single market, but few can match the range of new trade opportunities provided on a global basis by the WTO.

ANNEX: Dispute Settlement in the World Trade Organization

GATT Articles XXII and XXIII have served as the basic guidelines for the dispute settlement mechanism (DSM) in the multilateral trading system. The DSM is designed to address two types of disputes:

o those involving alleged violations of WTO rules or liberalization commitments; and

o those involving actions which nullify or impair the value of concessions granted in previous negotiations, whether or not the action itself is consistent with international obligations (so-called "non-violation" cases).

The Dispute Settlement Understanding (DSU) negotiated in the Uruguay Round strengthened the WTO dispute settlement mechanism by establishing new panel procedures, a new appellate process, and new compliance provisions. Under the DSU, panels must be established within 30 days of a request from a member country and panel reports should normally be issued 6 to 9 months later. Unlike past procedures, panel findings will be automatically approved unless appealed or blocked by consensus; previously, consensus was needed to approve panel reports and any country (including the defendant) could block the process.

Because panel rulings are now harder to block and are binding on the participants, the DSU adopts a new appellate procedure to allow countries to contest findings regarding "issues of law covered in the panel report and legal interpretations developed by the panel" (DSU Article 17.6). The new Appellate Body will normally issue its ruling on the appeal within 60 days, which will be automatically adopted unless there is a consensus against implementing the decision.

Finally, the DSU sets time periods for compliance with panel rulings, and allows the "injured" country to retaliate in the event of noncompliance (subject to disapproval by consensus of the members).[3] If the panel recommendations have not been fully implemented within a reasonable period of time (agreed to by the disputants or imposed by an arbitrator), and subsequently no satisfactory compensation has been agreed, the complaining country has the right to retaliate by suspending the application of WTO obligations to the offending country (DSU Article 22.2). Here again, the new rules reverse the presumption that countries must receive a positive vote before they can act unilaterally. Retaliation is automatically authorized unless there is a consensus -- including the complaining country -- against such action (DSU Article 22.6).

From start to finish, the dispute process should not take more than 20 months--and less if the panel decision is not appealed (see figure 1). As a result, disputes will not languish and WTO violations will be remedied more quickly.

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[3] However, in "nonviolation" cases a panel ruling cannot require the withdrawal of the disputed measure, but it can make a nonbinding recommendation as to a mutually satisfactory adjustment as a final settlement of the dispute (DSU Article 26.1).

Chairman CRANE. Thank you.
Dr. Destler.

STATEMENT OF I.M. DESTLER, PH.D., PROFESSOR AND DIRECTOR, CENTER FOR INTERNATIONAL AND SECURITY STUDIES, UNIVERSITY OF MARYLAND; AND VISITING FELLOW, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. DESTLER. Thank you, Chairman Crane, Congressman Rangel, Congressman Payne.

I speak as a scholar who has watched and written about U.S. trade policy and trade politics over the last 25 years or so, and I would briefly characterize the World Trade Organization as a very modest step in the direction in which Republican and Democratic Presidents and Congresses have been walking for the past 62 years.

Essentially, we have been using control of access of the U.S. market all through this time to bargain down trade barriers in other national markets, whether it was bilateral or multilateral agreements, whether it was reducing tariffs, or attacking nontariff barriers. The basic principle remained the same.

We got other nations to lower their barriers and promise to keep them down by committing ourselves to do likewise.

In so doing, we limited our freedom of action. We did not take away our sovereignty, but we did tie our hands, and I would argue this was mostly good.

It was good because market openness makes our own economy more efficient. Merchandise exports have tripled as a share of U.S. goods production since 1950, for example, and exports of services have grown even faster.

Agreements have also been acted as a brake on protectionism in the United States, and one reason was that trade agreements gave executive officials and Members of Congress a solid argument, a solid reason for resisting protectionism.

They could point out it was not only bad policy, but contrary to obligations they had undertaken in the name of the United States.

But as you Members of Congress know all too well, problems and frustrations in our trading relations with other nations have hardly gone away. They seemed, almost, to grow.

And often they come when we have in fact negotiated what we think is a good agreement reducing a foreign barrier, but something gets in the way. We do not seem to be able to achieve our objective. Something or somebody seems to be taking away the market access we have bargained for in good faith.

And this is where the World Trade Organization comes in. It is certainly not a solution to this kind of problem. The WTO is not a solution to anything. It is a fledgling, new organization, beginning to find its way.

Despite the fulminations of one of our Presidential candidates, the World Trade Organization is not a world power. It cannot force another nation to change practices to which we object, any more than it can force the United States to take any specific action we do not decide to take through our constitutional processes.

But it does give us an opportunity to make our case, and gain a clear judgment from the community of trading nations.

And if we win, and if the offending country does not eliminate the offending practice, or modify it to our satisfaction, we have the right, under international trade law, to impose trade barriers in return.

Others can of course do the same thing to us. We cannot expect to win all the cases. We may well be in the process of losing one with Venezuela on standards of reformulating gasoline right now.

But I think if we exploit the process, we can win more than our share of cases for a range of reasons, including the fact that, on average, our market is significantly more open than other markets.

A gradual strengthening of the WTO dispute settlement procedure is therefore in the U.S. interest, and I think "gradual" is the best we can hope for internationally. Gradual may be all we can handle domestically as well, rightly or wrongly, and I think mainly wrongly, the WTO has become a devil in our domestic debates. It is in this context, it seems to me, that we should view Senator Bob Dole's proposal to establish a WTO Dispute Settlement Review Commission, to examine all final dispute settlement reports adverse to the United States, for their procedural legitimacy.

At first glance, this seems to be anti-WTO because the Dole proposal would establish a process by which Congress could vote on withdrawing from the organization. But to force such a vote, this commission would have to find in a 5-year period, three cases where a WTO panel had demonstrably exceeded its authority or acted arbitrarily or capriciously.

Such findings are probably unlikely, especially if such a commission is watching out for them.

Moreover, in cases where the commission found no such procedural violations, its declarations would give domestic legitimacy to specific WTO panel findings against existing U.S. laws and practices.

Therefore, it seems to me the Dole proposal could help us come to terms with the new organization and the new dispute settlement procedures as long as Congress sticks to the specific language which the Senator unveiled, with Clinton administration acquiescence, on Thanksgiving eve of 1994.

There is much else that can be done by the United States to build up the WTO process, and make it serve U.S. interests. I would certainly endorse the suggestions my friend and colleague, Jeff Schott, has presented here.

Above all, we need to be focusing less on cases we could lose and more on pressing cases that we can win.

The bottom line, in terms of my own view, and my own testimony, is that the Uruguay Round Agreements offer us enhanced opportunity for pursuing the sorts of grievances we typically think of pursuing under section 301, within the WTO structure, because more issues are now covered by international trade law, and because cases are more likely to reach definitive outcomes. And I think we should actively and aggressively pursue our trade interests within this forum.

Thank you.

[The prepared statement follows:]

"The WTO: A Modest Step on a Long Road"

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Testimony Prepared for Delivery Before the Subcommittee on Trade
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The World Trade Organization is a modest step in the direction that Republican and Democratic Presidents and Congresses have been walking in for the past 62 years--ever since the Reciprocal Trade Agreements Act of 1934. From that time forward, we Americans have been using our control of access to the US market to bargain down trade barriers in other national markets. We began with bilateral trade agreements, moving to multilateral negotiations after World War II. We began by negotiating down tariff rates, moving in the 1970s to reductions of non-tariff barriers--and "fast track" authority to implement them. But though the form of negotiations changed, the basic principle remained the same. We got other nations to lower their trade barriers, and promise to keep them down, by committing ourselves to do likewise.[1]

In completing and signing and implementing these trade agreements, the United States has limited its freedom of action--we promised not bring our tariffs back up, for example. We did not limit our *sovereignty*, for no other nation or group of nations can make US law. But we did tie our hands. And that, I would argue, was good.

It was good because market openness makes our own economy more efficient, and because our commitments to open our market were exchanged for commitments by other nations to open theirs. The global reduction of commercial barriers which resulted has allowed international trade to flourish, particularly for the United States. Since 1950, merchandise exports have tripled as a share of US goods production, and exports of services have grown even faster. US imports grew also, of course, but that was mostly good too, because it enabled us to concentrate more of our economic resources on doing the things that we do best, with greatest efficiency.

Reciprocal trade agreements were good for yet another reason: they acted as a brake on protectionism in the United States. The act of negotiating these agreements brought exporters who gain from barrier-reduction into the trade-political game, balancing the ever-present force of those who had trouble competing with imports. Once signed, trade agreements gave executive officials and members of Congress a solid reason to resist protectionism--it was not only bad policy, but contrary to obligations which they had undertaken in the name of the United States.

Still, problems and frustrations have remained. Sometimes they come from our inability to get agreement to dismantle an egregious trade barrier: the European Union's Common Agricultural Policy comes to mind. Often, however, they come when we have in fact negotiated a reduction in foreign trade barriers, but our producers still have trouble selling. Perhaps a trading partner will pass a law or impose a regulation--establishing new product standards or inspection requirements, perhaps--which effectively takes away the market access we have bargained for in good faith. Frustrations with such foreign practices have led successive Congresses to enact Section 301, and Super 301, and Special 301, and successive administrations to use them with growing verve.

This is where the World Trade Organization comes in. It is not a *solution* to this kind of problem: it is a fledgling new organization, not strong enough to be a solution to anything. Despite the fulminations of one of our Presidential candidates, the World Trade Organization is not a World Power. It cannot force

[1]For more on this, see my *American Trade Politics*, third edition (Institute for International Economics and Twentieth Century Fund, 1995), esp. chs. 2, 4 and 5.

another nation to change practices to which we object, any more than it can force the United States to take any specific action we do not decide to take through our own Constitutional processes.

But it does give us an opportunity to make our case and gain a clear judgement from the community of trading nations. We can file a case, and unlike in the old procedures under GATT, the offending country cannot block its resolution. And if we win, and that country does not eliminate the offending practice or modify it to our satisfaction, we have the right, under international trade law, to impose trade barriers in return.

Others can, of course, do the same to us, and we cannot expect to win all cases. We are already in the process of losing one with Venezuela on standards for reformulated gasoline. But if we exploit the process effectively, we could well win more than our share of cases. There are two reasons. First, other nations tend to have more barriers to trade than we do. Second, others tend to be less open about their barriers than we are, less likely to follow clearly enacted and clearly promulgated laws in enforcing them. The WTO will help us to bring such practices into the open and go after them. It will over time, if we use it effectively, make the process of addressing violations of trade agreements more systematic and reliable.

A gradual strengthening of WTO dispute settlement procedures is therefore in the US interest--and gradual is the best we can hope for internationally. Gradual may be all we can handle domestically as well. For rightly or wrongly, and I think mainly wrongly, the WTO has become a devil in our domestic debates. There is genuine anxiety (hard to say how broad-based) about our losing control, anxiety linked somehow to the broader disruption of technological change in today's global economy. Thus it is reasonable for politicians to seek mechanisms which will assuage fears about foreign bureaucrats riding roughshod over American rights and interests.

It is in this context that we should view Senator Bob Dole's proposal to establish a "WTO Dispute Settlement Review Commission" in the United States to examine "all final dispute settlement reports. . . adverse to the United States" for their *procedural* legitimacy. At first glance this seems anti-WTO, and *Congressional Quarterly* put S. 16 in the "closed door," market-restricting category two weeks ago when it listed pending trade legislation. But I am not so sure.

It is true that the Dole bill would establish a process by which Congress could vote on withdrawing from the organization, a step that would not serve US interests. But to force a vote, the Commission would have to find, in a five-year period, three cases where a WTO panel had "demonstrably exceeded its authority," or "acted arbitrarily or capriciously." Such findings are rather unlikely, particularly if the Dole Commission is out there watching and providing some discipline (critics would call it political pressure) on the review process. Moreover, in cases where the Commission found no such procedural violations, its declarations would give domestic legitimacy to specific WTO panel findings against existing US laws or practices. It would strengthen the credibility of those WTO panel reports that met its procedural specifications. The Dole proposal could therefore help us come to terms with the new organization and the new dispute settlement procedures, as long as Congress sticks to the specific language which the Senator unveiled, with Clinton Administration acquiescence, on Thanksgiving eve 1994.

There is much else that can be done by the United States to build up the WTO process and make it serve US interests. Above all, we need to be focusing less on cases we could lose, and more on pressing cases that we can win. I don't necessarily mean the big disputes: I don't think the WTO was strong enough to have handled the US-Japan auto dispute of last spring. But there is one important thing we should not forget: that the Uruguay Round agreements offer us enhanced opportunity for pursuing Section 301-type grievances within the WTO structure: because more issues are now covered by international trade law, and because cases are more likely to reach definitive outcomes. This gives 301 a legitimacy, an international acceptance, which it has previously lacked. We should exploit this opportunity and use it to advance our trading interests.

Chairman CRANE. Thank you, Dr. Destler.
Mr. Cobb.

STATEMENT OF JOE COBB, JOHN M. OLIN SENIOR FELLOW, HERITAGE FOUNDATION

Mr. COBB. Mr. Chairman, and Members of the Subcommittee, other witnesses have covered a number of the technical issues relating to the World Trade Organization, but I want to make a few points about the general reasons why we all worked so hard to create the Uruguay Round and establish the WTO.

First, equal international rules are in our national interest. The WTO is essentially an organization to establish and defend the rules of the game. The name of the game under GATT and the WTO is nondiscrimination. The Uruguay Round Agreement is designed to be a common script for all governments to follow in the way they treat the businesspeople and products from other countries. The international trade rules are equal for all players, but the players have to voluntarily follow the rules or else other players will withdraw the privileges of the game.

Two rules in particular are the cornerstone of the World Trade Organization: The most-favored-nation principle and national treatment. MFN sets the standard for nondiscrimination at a country's border and national treatment sets the standard for nondiscrimination inside a country. The idea of both rules is that all governments will treat the businesspeople and their products and services from other countries equally under their laws; that they will not discriminate against some of them for the benefit of others.

National treatment is an original American principle that is written into our Constitution. Article IV, section 2 says, "The citizens of each State shall be entitled to all privileges and immunities of citizens in the several States." Before the Constitution, in the early days of our country, State and local governments regularly enacted laws that discriminated against the businesspeople and the trade of neighboring States. Without the early adoption of free trade and national treatment among all of our States, this country could never have developed economically to become the wealthiest Nation on Earth.

Of course, the hope we have for the 21st century is to spread the American system to every other country. Critics of the World Trade Organization and of trade agreements in general may well say they do favor discrimination. They do not want foreign businesspeople and foreign products to be treated in the United States the same as products produced here. But the question they have to answer then must be, do we want Americans to be discriminated against by foreign governments when they try to do business or sell products to other countries?

The World Trade Organization is the place to go and get equal treatment for Americans. But the concept of playing fair and following equal rules naturally implies Americans will also play by the same rules. In my written remarks I describe the way trade sanctions work and how the current dispute between Venezuela, Brazil, and the United States over gasoline imports may turn out.

But to keep this short, let me stick to the analogy of a game. If you were playing cards or chess with someone and you caught

them cheating, the sanction you would have is to quit playing the game. The system of trade sanctions under the WTO works essentially the same way, but you do not stop trading with other countries if they discriminate. Instead, you are permitted to discriminate back at them in some equally unfair way. If there is going to be discrimination, it is better that it be supervised and moderated by an impartial agency like the World Trade Organization that keeps the relative economic cost of the discrimination equal and discourages the emotional trade war sentiments that often flare up.

The question Congress and the American people need to ask whenever our own laws are judged to be discriminatory, as in the case of the Venezuelan and Brazilian gasoline importers, is whether those laws were originally enacted for the purpose of discriminating for the economic benefit of some special interest group. Most of the time, unequal and discriminatory trade policies around the world are enacted to make special interest groups richer at the expense of other people.

The U.S. trade policy ought to serve our national interest. But when we pose the question, What is the national interest of the United States?, we should always put the question in context. Is something in the national interest of all Americans, or is it in the more narrow interest of only some Americans? If the answer is that only some Americans are made better off and that other Americans are made worse off, then the policy cannot really be a question of the national interest at all.

What the World Trade Organization does for us is to elevate the principle of nondiscrimination to a central focus in every government's economic policy, and that is very much in the interest of all Americans.

But if I have a few more minutes, let me direct a few remarks at the critics of the World Trade Organization: Those who would favor the American government discriminating against foreign goods and giving preferences to Americans.

Most of the time we talk about our trade and we say we want America to increase exports and reduce imports. That is the famous trade deficit issue. But we really should try to increase both. Both imports and exports are closely connected to creating high paying jobs in the United States and sustaining American industrial competitiveness. Just ask the Chrysler Corp. how it has adjusted its manufacturing system to become a world class competitor after almost going out of business in 1980. It has become a global company.

Increasing the volume of imports into the United States is good for two main reasons.

One, the variety and quality of goods and services is larger when the available producers we can choose among is larger than we would otherwise have without open trade. Supporters of the idea of restricting international trade are supporters of increasing government regulation in order to have fewer choices. That does not sound like a smart policy.

Two, competition makes for a stronger team. American producers are the best in the world because the United States is the most open market in the world. When trade policy keeps a market rel-

atively closed, it is actually giving less efficient producers a free ride at the expense of other businesses and families.

It is true when you open up a market to more and more businesspeople, some of the established businesses may not make as much profit. Some of them will close. Some jobs will be lost.

But helping people adjust to changes with more education and a helping hand is one thing, and pretending that change can be prevented is another.

The strongest benefit from international trade is its impact on our technological change. Every business executive has a responsibility to his stockholders and his workers to keep production right on the cutting edge of science and technology. But when a government pretends to do that business a favor by keeping out products that may be cheaper or have some slight advantage in our market, it is telling the business leaders and workers that they do not have to do anything to keep ahead of the competition because the government is willing to give them a free ride.

If our business leaders do not keep up with all the scientific and technological changes all of their competitors around the world are making, they are doomed in the long run regardless of all the protection our government might want to provide.

Thank you, Mr. Chairman. I will be happy to answer your questions.

[The prepared statement follows:]

United States House of Representatives
Committee on Ways and Means
Subcommittee on Trade

March 13, 1996

Remarks
of
Joe Cobb
John M. Olin Senior Fellow in Political Economy
THE HERITAGE FOUNDATION
Washington, DC 20002

Mr. Chairman and members of the Subcommittee. Thank you for allowing me to appear here today to discuss with you some of the issues about the World Trade Organization and international trade agreements in general that have become increasingly controversial in the past few years. I am appearing here today in my capacity as a private citizen, of course, and not as a representative of The Heritage Foundation. Appended at the end of my statement, however, is a disclosure of information about The Heritage Foundation, which may be of interest to the Committee.

I want to limit my remarks today to two questions:

First, is United States participation in the World Trade Organization in our long term interests?

Second, are multilateral trade deals good for the United States?

Congress has certainly heard voices that argue "No" to both questions. My views are strongly on the side of both active participation in the WTO, that it is very much in our long term interests, and that multilateral trade agreements are good for the United States.

Equal International Rules are in our National Interest

How can it be in the national interest of the United States to participate in an organization where we have only one vote out of about 130, and in which there is an arbitration process where other countries can bring cases and accuse our government of wrong behavior? You are certainly aware of the recent case brought by Venezuela and Brazil regarding gasoline and U.S. clean air standards. The World Trade Organization has recently issued an opinion that a regulation of the Environmental Protection Agency not to allow any waivers for petroleum refiners in Venezuela and Brazil, is wrong and if the United States does not change it, they will impose trade sanctions. The United States is appealing this finding. I will discuss this case briefly later in my testimony.

I think that most people hear the name, "World Trade Organization," and think it sounds like some kind of world government organization. During the very heated debate two years ago, this was exactly how opponents of the WTO described it. The fact that the WTO operates on the basis of equality among all its members, with the smallest government having the same vote as the greatest power on earth certainly fits the analogy of the United Nations General Assembly.

But that is really all there is to the argument. It is just an analogy. And a very bad analogy at that. A "world government" would have some kind of police powers, the power to compel its will on its member governments. But under our Constitution, and the Supreme Court decisions that have been handed down regarding treaties and international agreements, nothing about the World Trade Organization can overturn an Act of Congress or any clause in the Constitution.[1]

The correct analogy for the Uruguay Round Agreement, and the World Trade Organization, is to compare it to ***the rules of a game.*** The Uruguay Round agreement is designed to be a common script for all governments to follow in the treatment of business people and products from other countries. As negotiated among all the signatories to the Uruguay Round, the rules of fair and open trade are spelled out and each government is committed to follow the rules. The central principle of the World Trade Organization is the equality of those rules. It is true that a period to phase in the rules for less developed countries was agreed to in the Uruguay Round, but that just further underscores that the rules do apply to all countries. There is not a permanent set of exceptions for some governments.

Two Rules Above All Others

Two rules, in particular, are the cornerstone of the World Trade Organization: The Most Favored Nation principle and National Treatment.

The Most Favored Nation principle simply says that a government, following the rules, will treat the business people and their products and services from other countries equally under its laws, and will not discriminate against some of them for the benefit of others. A country may have tariffs and it may have other regulations at its borders to control trade, but when foreign business people and their products and services arrive at the country's borders, there should be no special rules that discriminate among them. That is why quotas and other such measures are not allowed. If one businessman has a quota to import something, necessarily some other businessman must be denied permission to import the same thing. A tariff does not discriminate between the two of them. Each one pays the tax on his imports, and the tax is equal for them both.

National Treatment is a principle that is very central to the American political and economic system, inasmuch as it is written into our Constitution. Article IV, Section 2, says:

> The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the Several States.

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[1] *Whitney v. Robertson,* 124 U.S. 190, 195 (1888) and *Botiller v. Dominguez,* 130 U.S. 238, 247 (1889). The Court in *Botiller* said "the provisions of a treaty ... which the government of the United States, as a sovereign power, chooses to disregard" cannot be enforced. To strengthen and clarify the law, since it was so controversial in 1994, Congress enacted Section 102(a)(1) of P.L. 103-465, the GATT implementing legislation, which says, "United States Law to Prevail in Conflict — No provision of any of the Uruguay Round Agreements, nor the application of any such provision to any person or circumstance, that is inconsistent with any law of the United States shall have effect."

It is a well know fact that in the early days of our country, state and local governments enacted some laws that discriminated against the business people and the trade of neighboring states. Without the early adoption of free trade and national treatment among all of our states, this country could never have developed economically to become the wealthiest nation on earth.

Critics of the World Trade Organization and of trade agreements in general may well say that they do not want foreign business people and foreign products to be treated in the United States the same as products produced here or businesses owned by Americans, but the question then has to be, "Do we want Americans to be discriminated against by foreign governments when they try to do business or sell products to other countries?"

The World Trade Organization provides a framework to go and try to get equal treatment for Americans. But the concept of playing fair and following equal rules naturally implies that Americans will also play by the same rules.

The Effect of Trade Sanctions

Following the analogy of the rules of a game one step farther, consider the consequences of some government violating the rules, and imposing some discrimination on the products or business people of other countries.

In particular, take the current case on appeal at the World Trade Organization on refined petroleum products. In general the issue is whether or not there is a technical barrier under the Clean Air Act for "reformulated gasoline" that discriminates against this product from refineries in Venezuela and Brazil. There are essentially three different ways that domestic U.S. refiners can comply with the regulations of the Environmental Protection Agency, but the EPA regulations do not allow foreign refiners to use the second or third method. They are treated differently from the domestic refiners.

I am not prepared to argue the merits of the case here today, but merely to note that Congress actively told the Environmental Protection Agency not to treat the foreign refiners the same as the domestic refiners. So the World Trade Organization has issued an opinion that Venezuela and Brazil are being discriminated against.

Under the rules of the game, if the final decision all around is that (1) the foreign refiners are discriminated against, and (2) the United States intends to keep on discriminating, then the World Trade Organization will authorize Venezuela and Brazil to put up some approximately equal discrimination against something that U.S. businesses want to sell in the Venezuelan and Brazilian markets. Some American business people who want to do business in those countries will have to suffer some discrimination, just as the foreign refiners who wanted to sell gasoline in the United States are being discriminated against.

If you were playing cards or chess with someone and you caught them cheating, the sanction you would have is to quit playing the game with them. In the international trade game, the procedure is far less serious. In the first place, the best outcome would be for all governments to follow the spirit of the Uruguay Round and not discriminate against business people from other countries. But if there is going to be discrimination, it is better that it should be supervised and moderated by an impartial agency like the World Trade Organization that keeps the relative economic cost of the discrimination equal, and discourages the emotional "trade war" sentiments that often flare up.

Helping and Hurting Different People

The result of any trade sanctions that Venezuela or Brazil may impose, if they prevail at the World Trade Organization, will be to hurt some American business people. Instead of being able to sell products in those countries on equal terms with all other importers, they will be at a disadvantage. This is exactly the kind of treatment that the United States government strongly opposes, and yet it comes as the result of the U.S. government itself being found guilty of discrimination against the foreign refiners.

The question that Congress and the American people need to ask is whether the law or regulation or trade practice that has been investigated at the World Trade Organization, and has been judged to be discriminatory, was originally enacted ***for the purpose of discriminating*** to the economic benefit of some special interest group. Most of the time, unequal and discriminatory trade policies around the world are enacted to make some people richer or more profitable at the expense of other people.

When we pose the question, "What is the National Interest of the United States," we should always put the question in context. Is something in the national interest ***of all Americans,*** or is it in the more narrow interest ***of some Americans?*** If the answer is that only some Americans are made better off, and that other Americans are made worse off, then the policy cannot really be a question of the national interest at all. Unfortunately, in most of the debates about U.S. trade policy, the narrow interests of some Americans are all that policy makers point to. The costs of a policy to sometimes many more numerous other Americans is all too often overlooked.

Are Multilateral Trade Deals Good for the United States?

There are two related issues involving international trade agreements. The first is whether increasing trade is good for the economy at all, and the second is whether the best way to negotiate and enter into trade agreements is on a bilateral or reciprocal basis instead of on a multilateral basis.

When governments start to consider the idea of reducing trade barriers, there are always economic interests that will benefit from that policy — not just

exporters, but also other businesses that will be able to import the parts and materials they need from a wider selection of suppliers, perhaps at lower prices. There also are quite often other economic interests that will not benefit from reducing trade barriers. Historical experience has shown that the economic interests that want to keep the trade barriers are usually more strongly motivated, because what they may be about to lose are real, visible jobs, fixed investments in plant and equipment, and other economic resources. The gains from opening up the trade gates may be something in the future — economic growth, potential new jobs, potential higher standards of living. But in political debates, what people can see and point to is often a more powerful force than the promises or forecasts of economists.

The bilateral or reciprocal approach to negotiating trade agreements would seem to be the way to trade off gains and losses. One country will agree to open up its market to your products if you agree to open up your market to some products from over there. What is wrong with this idea is that it relies on the same mistaken idea as "centrally planned" or socialistic economic systems. Rather than letting individual business people, explore new ways to bring products to market and find customers, the governments and bureaucratic planners are trying to pick and choose what sorts of products or services will be allowed into the market.

There are many other problems with the bilateral or reciprocal approach, as well. For one thing, the rules that a country might negotiate with one trading partner would be different, to some degree, from the rules it would negotiate with a different trading partner. Different rules and regulations for doing business are frustrating to business people who might want to sell their products to both countries. Second, the pressure to withhold corners of the market in order to protect special interests is far more likely when very specific, "planned economy" trade deals are being negotiated.

The broader, multilateral approach has two very distinct advantages. First, the general principle that government economic regulations are not good, but are bad for economic growth and development, is at the top of the negotiating agenda. And second, the rules that are agreed to are equal rules for all players in the game. With equal rules, the trade is obviously "fair" in the most basic sense of the word.

Less Government Regulation Makes Us a Stronger Team

Most of the time, we think America ought to increase exports and reduce imports. But we really should try to increase both. Of course it is always good to increase our export sales, but that is only half the story. The best part of increasing our trade is to make it possible to buy more imports with the money our nation makes from selling exports.

Just like a shopkeeper who sells groceries or hardware in order to buy a new home or clothes for his family, the reason why we work is to buy the things we want. The same is true in international trade. We tend to fall into the mistake of looking at exports as good, because other people pay us for them, and imports are

some how less desirable because we have to pay other people. Both imports and exports are closely connected to creating high paying jobs in the United States and sustaining American industrial competitiveness. Just ask the Chrysler Corporation.

Increasing the volume of imports into the United States is good for two main reasons:

(1) The variety and quality of goods and services is larger when the available producers we can choose among is larger than we would otherwise have without open trade. Sure, it is great to get bargains, in the form of cheaper imports, but the real issue is greater choice, greater variety. In that way, the American consumer can choose quality regardless of whether it comes from domestic or foreign sources, and even if it is more expensive. Supporters of the idea of restricting international trade are supporters of increasing government regulation in order to have fewer choices. That does not sound like a smart policy.

(2) Competition makes for a stronger team. American producers are the best in the world because the United States is the most open market in the world. If our market were partially closed, how would anyone know if we were the best? The degree of protection (closedness) would obscure that knowledge from our vision. Whenever a foreign producer gets a small edge on an American manufacturer, that sends a strong signal to the Americans that they have to focus on the problem and solve it — figure our how to catch up and surpass the competition again, as our people always have done. When trade policy keeps a market relatively closed, it is actually giving less efficient American producers a free ride, at the expense of other American businesses and families.

Trade is the Messenger, but Technology is the Message

There is a lot of discussion among opponents of more open international trade that jobs are lost and that less well educated American workers are at a disadvantage when they have to compete against cheap foreign labor. This is a hard argument to refute, because there is some truth in it. It is true that when you open up a market to more and more business people, some of the established businesses may not make as much profit. Some of them will close. Some jobs will be lost. And in the economic adjustment process, it is also true that workers who are less well equipped are the ones who will have the most trouble adjusting to the changes.

But helping people adjust to changes with more education and a helping hand is one thing, and pretending that change can be prevented is another. The most difficult period of adjustment to an opening of trade is in the first few years, because all of the less efficient investments and market arrangements that were profitable when the trade barriers were up are going to become unprofitable as soon as they come down. No new investments will make those same mistakes. Workers will not train for jobs that are no longer suitable in the more open marketplace. But the people who have to make the changes will suffer losses.

But the supposed pain and suffering from trade agreements, like NAFTA and GATT, are very much exaggerated. A few months ago, another think tank here in Washington publicized the statistics that "one million jobs had been lost due to NAFTA in 1995," the first year. One million jobs sounds like a lot of jobs, but put that into context.

Every week, the U.S. Department of Labor announces the number of new claims for unemployment insurance across the country. Last week, the number was about 360,000. Every Thursday morning, the number is announced and it is almost always something between 300,000 and 400,000 new claims for unemployment insurance. That is a million new claims in about three weeks. The United States has a very large and robust labor market, and all these jobs are being lost all of the time. It is not a happy thing to lose a job, but the unemployment rate is not going up. Last week, the Labor Department announced that it went down.

Trade agreements hardly have any effect on U.S. unemployment at all. But ***they do have an impact on technological change.*** Every business executive has a responsibility to his stockholders and his workers to keep production right on the cutting edge of science and technology. When a government tries to do that business a favor by keeping out products that are cheaper or that have some other slight advantage in the market over the domestic products, it is telling the business leaders and workers that they don't have to do anything to keep ahead of the competition, because the government is willing to protect them instead.

Of course, this is unfair to all of the other citizens who might be better off if they could get the technological advantages of the superior or cheaper products, but the genuine long term damage is done to the protected businesses and workers themselves, because no form of protection is permanent. If a business leader does not keep up with technological changes and the progress that all of his competitors world wide are making, he is doomed in the long run regardless of all the protection a government might want to provide.

Thank you, Mr. Chairman. I will be happy to answer any questions you may have.

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Chairman CRANE. Thank you, Mr. Cobb.
Ms. Hecker.

STATEMENT OF JAYETTA Z. HECKER, ASSOCIATE DIRECTOR, INTERNATIONAL RELATIONS AND TRADE ISSUES, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. HECKER. Thank you, Mr. Chairman. I, too, will try to abbreviate my remarks and focus exclusively on the comments that others really have not covered.

One is that when we testified and gave our report on the complete Uruguay Round, we noted that some sectors bear more of the cost than others. At that time we shared the recommendation of an ongoing GAO effort that the patchwork of worker adjustment assistance programs really needed to be improved because basically, there are some losers and there are some sectors that bear a disproportionate cost, and we really do have an inefficient system of adjustment assistance in this country and reforms are really needed there. No one brought that up, and I thought I would just put that on the table because that is really how we address questions about the equity of trade. Yes, there is a net benefit, but there should be some transfer of some of that gain to those who bear the disproportionate loss.

A second point is a bit of a detail on the issue of notification. It is the kind of an issue you would expect GAO to be looking at, but it is rather an important one. The new agreement called for over 200 filings by members. What is important about them is they provide a basis for the kind of transparency and monitoring that is really needed of the agreement. There have been some delays. Even the United States has been delayed in getting those notifications filed.

But the real story I think was shared earlier when it was discussed that these continue not to be made available to business and the private sector. I think that is really an important objective the United States has been pushing toward, and I think the suggestions that this Subcommittee might want to get behind the challenges internationally is one of merit. This will definitely improve the kind of monitoring and oversight, because the agencies are clearly constrained in how much attention they can give to this. But businesses will have a lot of interest in the antidumping rules of different countries, the subsidy practices of different countries, the food safety standards and regulations. All of these are things that really should in good practice be made available to business.

Another issue where there was some limited discussion of and I just wanted to highlight, because it is a very important area, is the area of agriculture. This was the sector that the most projected economic gains were expected, but close monitoring is clearly required here. In fact, there are already significant problems being experienced by American agriculture. While there has been some growth in agricultural trade, there is an increased use of food safety standards, or sanitary-phytosanitary standards as they are more technically called, as a potential barrier to entry of goods. There may be reason to believe that some are not really based on science. This problem was anticipated. It was a new agreement that was nego-

tiated as part of the Round, and hopefully the process will work to make sure that unscientific measures are interrupted.

Another topic that was not mentioned really by anyone here is State trading enterprises. There was very limited coverage in the Round of requirements on State trading enterprises, and the United States has been working vigorously to improve the transparency of these government-owned or sponsored trading organizations. One of the issues we think is very important is that the existing measures really may not be effective in providing sufficient controls and oversight of the State-dominated economies like China and Russia, which of course, as we know, are seeking to join the WTO.

Finally, I want to close, because it was a matter of some considerable discussion, that we are, for you and others, doing a review of the implementation of the Agreement on Textiles and Clothing. Some of the contentious issues that were put on the table today are ones we hope to try to sort out. We are in the middle of that work, but we are looking at the functions of CITA, the decisionmaking there, the extent to which their transparency compares with similar foreign and domestic processes, and whether there are some opportunities to improve it. So we will be pleased to report to you and see if we can reconcile some of the disparate views that were presented here today.

That concludes my remarks, Mr. Chairman.

Thank you.

[The prepared statement follows:]

STATEMENT OF JAYETTA Z. HECKER
ASSOCIATE DIRECTOR
INTERNATIONAL RELATIONS AND TRADE ISSUES
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U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to provide some preliminary observations on the implementation of the Uruguay Round agreements, and the operations of the new World Trade Organization (WTO). Based on our past and ongoing work,[1] I will provide an overview of the implementation of the agreements, then talk about some specific issues that are of particular concern to U.S. decisionmakers, and finally discuss future WTO endeavors.

OVERVIEW

We believe that the United States generally achieved its negotiating objectives in the Uruguay Round, and most studies we reviewed projected net economic gains to the United States and the world economy.[2] The General Agreement on Tariffs and Trade (GATT) Uruguay Round agreements are the most comprehensive multilateral trade agreements in history. For example, signatories (1) agreed to open markets by reducing tariff and nontariff barriers; (2) strengthened multilateral disciplines on unfair trade practices, specifically rules concerning government subsidies and "dumping;" (3) established disciplines to cover new areas such as intellectual property rights and trade in services; (4) expanded coverage of GATT rules and procedures over areas such as agriculture and textiles and clothing; and (5) created WTO, which replaced the preexisting GATT organizational structure and strengthened dispute settlement procedures.

Despite expectations for overall economic gains, we noted in recent reports that specific industry organizations and domestic interest groups had concerns that the agreement would adversely affect some U.S. interests. For example, some believe that they did not gain adequate access to overseas markets or that they would lose protection provided by U.S. trade laws. In addition, because some sectors of the U.S. economy--notably textiles and apparel--and their workers will likely bear the costs of economic adjustment, the existing patchwork of reemployment assistance programs aimed at dislocated workers needs to be improved.[3] Our work has indicated that it was difficult to predict outcomes and not all the effects of such a wide-ranging agreement will become apparent in the near term;[4] important issues will evolve over a period of years during GATT implementation. We have identified provisions to be monitored to assure that commitments are fulfilled and the expected benefits of the agreements are realized. Moreover, our work on the GATT Tokyo Round agreements, negotiated in the 1970s, and numerous bilateral agreements has demonstrated that trade agreements are not always fully implemented.

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[1]My statement today is based on some limited monitoring of general WTO implementation issues we conducted last fall in Washington and Geneva. It is also based on our work for your Subcommittee and other Members of Congress looking at several specific WTO-related issues regarding (1) agriculture, (2) sanitary and phytosanitary (SPS) product standards for food safety, (3) state trading enterprises (STEs), (4) textiles and clothing, and (5) financial services.

[2]See The General Agreement on Tariffs and Trade: Uruguay Round Final Act Should Produce Overall U.S. Economic Gains (GAO/GGD-94-83a & b, July 29, 1994), International Trade: Observations on the Uruguay Round Agreement (GAO/T-GGD-94-98, Feb. 22, 1994), and General Agreement on Tariffs and Trade: Agriculture Department's Projected Benefits Are Subject to Some Uncertainty (GAO/GGD/RCED-94-272, July 22, 1994).

[3]See Multiple Employment Training Programs: Major Overhaul Is Needed to Reduce Costs, Streamline the Bureaucracy and Improve Results (GAO/T-HEHS-95-53, Jan. 10, 1995); and Trade Adjustment Assistance Program Flawed (GAO/T-HEHS-94-4, Oct. 19, 1993).

[4]See International Trade: Impact of the Uruguay Round Agreement on the Export Enhancement Program (GAO/GGD-94-180BR, Aug. 5, 1995).

Implementation of the Uruguay Round agreements, which generally began to go into force on January 1, 1995, is complex, and it will take years before the results can be assessed.[5] Nevertheless, our work highlights the following issues: (1) the WTO's organizational structure and the secretariat's budget have grown from 1994 to 1996 to coincid with new duties and responsibilities approved by the member countries; (2) faced with over 200 requirements, many member nations have not yet provided some of the notifications of laws or other information as called for in the agreements; (3) this year provides the first opportunity to review whether anticipated U.S. gains in agriculture will materialize, as countries begin to report on meeting their initial commitments; (4) the new agreements require that food safety measures be based on sound science, but U.S. agricultural exporters seem to be encountering more problems with other countries' measures and a number of formal disputes have already been filed with WTO; (5) while efforts are underway to improve transparency provisions regarding state trading, these provisions alone may not be effective when applied to state-dominated economies, like China and Russia, seeking to join WTO; (6) while textile and apparel quotas will be phased out over 10 years, the United States has continued to use its authority to impose quotas during the phase-out period and will not lift most apparel quotas until 2005; (7) despite the end of the Uruguay Round, some areas, like services, are still subject to ongoing negotiations; (8) there were 25 disputes brought before WTO in 1995 by various countries, including some involving the United States. The United States lost the first dispute settlement case regarding U.S. gasoline regulations brought by Brazil and Venezuela and is now appealing that decision.

ORGANIZATIONAL CHANGES

The WTO was established to provide a common institutional framework for multilateral trade agreements. Some observers have been concerned about the creation of this new international organization and its scope and size. The "new" WTO was based on a similar "provisional" GATT organizational structure that had evolved over decades. The Uruguay Round agreements created some new bodies; however, these new bodies address new areas of coverage, for example, the Councils for Trade in Services and for Trade-Related Aspects of Intellectual Property Rights. Other bodies, such as the WTO Committee on Anti-Dumping Practices, were "reconstituted" from those that already existed under the old GATT framework but that were given new responsibilities by the Uruguay Round agreements and had broader membership. The WTO secretariat, headed by its Director General, facilitates the work of the members. The work of the bodies organized under the WTO structure is still undertaken by representatives of the approximately 119 member governments, rather than the secretariat. Early meetings of some WTO committees were focused on establishing new working procedures and work agendas necessary to implement the Uruguay Round agreements.

In 1995, the WTO secretariat staff was composed of 445 permanent staff with a budget of about $83 million. This represented a 18-percent staff increase and about a 7-percent increase in the budget (correcting for inflation) from 1994 when the Uruguay Round agreements were signed. The members establish annual budgets and staff levels. The approved secretariat's 1996 budget represents a 10-percent rise over the 1995 level to further support the organization's wider scope and new responsibilities; it also includes an additional 15-percent increase in permanent staff. WTO officials in Geneva have told us that any additional increases in secretariat staffing are unlikely to be approved by the members in the foreseeable future.

The secretariat's duties include helping members organize meetings, gathering and disseminating information, and providing technical support to developing countries. Economists, statisticians, and legal staff provide analyses and advice to members. In the course of doing work over the last year, member government and secretariat officials told us it was important that the secretariat continue to not have a decision-making or enforcement role. These roles were reserved for the members (collectively).

UNFULFILLED NOTIFICATION REQUIREMENTS

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[5]According to the WTO secretariat, the almost 500 pages of text comprise 19 agreements, 24 decisions, 8 understandings, and 3 declarations. There are also approximately 24,000 pages of specific market access commitments.

An important, but laborious, aspect of implementing the Uruguay Round agreements centers on the many notification requirements placed upon member governments. These notifications are aimed at increasing transparency about members' actions and laws and therefore encourage accountability. Notifications take many forms. For example, one provision requires countries to file copies of their national legislation and regulations pertaining to antidumping measures. The information provided allows members to monitor each others' activities and, therefore, to enforce the terms of the agreements. In 1995, some WTO committees began reviewing the notifications they received from member governments.

The WTO Director General has noted some difficulties with members' fulfilling their notification requirements. Some foreign government and WTO secretariat officials told us in 1995 that the notification requirements were placing a burden on them and that they had not foreseen the magnitude of information they would be obligated to provide. The Director General's 1995 annual report estimated that the Uruguay Round agreements specified over 200 notification requirements. It also noted that many members were having problems understanding and fulfilling the requirements within the deadlines. While the report said that the developing countries faced particular problems, even the United States has missed some deadlines on filing information on subsidies and customs valuation laws. To address concerns about notifications, WTO members formed a working party in February 1995 to simplify, standardize, and consolidate the many notification obligations and procedures.

IMPLEMENTATION OF AGRICULTURE COMMITMENTS

One area of great economic importance to the United States during the Uruguay Round negotiations was agriculture; therefore, monitoring other countries' implementation of their commitments is essential to securing U.S. gains. Agricultural trade had traditionally received special treatment under GATT. For example, member countries were allowed to maintain certain measures in support of agricultural trade that were not permitted for trade in manufactured goods. As a result, government support and protection distorted international agricultural trade and became increasingly expensive for taxpayers and consumers.

The United States sought a fair and more market-oriented agricultural trading system, to be achieved through better rules and disciplines on government policies regarding agriculture. The United States sought disciplines in four major areas--market access, export subsidies, internal support, and food safety measures--and was largely successful, as the Agreement on Agriculture and the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures together contain disciplines in all of these areas.

Member countries are required to report to the new WTO Committee on Agriculture on their progress in implementing commitments on market access, export subsidies, and internal support. The agriculture agreement will be implemented over a 6-year period, and commitments are to be achieved gradually. After each year, countries are required to submit data to demonstrate how they are meeting their various commitments. The agreement allows countries to designate their own starting point for implementation during 1995, depending on domestic policies. In this regard, the U.S. period began on January 1, 1995, while the European Union (EU) period began on July 1, 1995. Therefore, in some cases, the first opportunity to closely review the extent to which other countries are meeting their agricultural commitments--and, thereby, whether anticipated U.S. gains are materializing--should occur later this year.

USE OF SPS MEASURES

At the outset of the Uruguay Round, the United States recognized that multilateral efforts to reduce traditional methods of protection and support for agriculture, such as quotas, tariffs, and subsidies, could be undermined if the use of food safety measures governing imports remained undisciplined. To prevent food safety measures from being used unjustifiably as nontariff trade barriers, the United States wanted countries to agree that these measures should be based on sound science. The SPS agreement recognizes that countries have a right to adopt measures to protect human, animal, and plant life or health. However, it requires, among other things, that

such measures be based on scientific principles, incorporate assessment of risk, and not act as disguised trade restrictions.

Carefully monitoring how countries implement the SPS agreement is essential to securing U.S. gains in agriculture. Since the end of the round, U.S. agricultural exporters seem to be encountering growing numbers of SPS-related problems. For example, South Korean practices for determining product shelf-life adversely affected U.S. meat exports and were the subject of recent consultations. As a result, Korea agreed to modify its practices. Meanwhile, the United States and Canada have both filed several other disputes that allege violations of the SPS agreement.

Key implementation and monitoring issues regarding the SPS agreement include examining (1) other countries' SPS measures that affect U.S. agricultural exports; (2) how the SPS agreement is being implemented; (3) whether its provisions will help U.S. exporters overcome unjustified SPS measures; and (4) how the administration is responding to problems U.S. exporters face. We have ongoing work addressing all of these issues.

GROWING IMPORTANCE OF STATE TRADING WITHIN WTO

Another issue that is currently important for agricultural trade but may have great future importance beyond agriculture is the role of state trading enterprises within WTO member countries. State trading enterprises (STEs) are generally considered to be governmental or nongovernmental enterprises that are authorized to engage in trade and are owned, sanctioned, or otherwise supported by the government. They may engage in a variety of activities, including importing and exporting, and they exist in several agricultural commodity sectors, including wheat, dairy, meat, oilseeds, sugar, tobacco, and fruits.

GATT accepts STEs as legitimate participants in trade but recognizes they can be operated so as to create serious obstacles to trade, especially those with a monopoly on imports or exports. Therefore, STEs are generally subject to GATT disciplines, including provisions that specifically address STE activities and WTO member country obligations. For example, member countries must indicate whether they have STEs, and if so, they must report regularly about their STEs' structure and activities. The goal of this reporting requirement is to provide transparency over STE activities in order to understand how they operate and what effect they may have on trade. However, as we reported in August 1995, compliance with this reporting requirement was poor from 1980 to 1994, and information about STE activities was limited.[6]

Although state trading was not a major issue during the Uruguay Round, the United States proposed clarifying the application of all GATT disciplines to STEs and increasing the transparency of state trading practices. Progress was made in meeting U.S. objectives, as the Uruguay Round (1) enhanced GATT rules governing STEs, (2) addressed procedural weaknesses for collecting information, and (3) established a working party to review the type of information members report. Within this working party, the United States is suggesting ways to make STE activities even more transparent. It is too early to assess whether the changes made will improve compliance with the STE reporting requirements. By mid-February, only 34 WTO members had met the requirement--or roughly 29 percent of all members. Still, this response rate is higher than during the earlier years we reviewed. We continue to examine this important issue and are presently reviewing the operations of select STEs.

Looking toward the future, officials from the United States and other countries told us in 1995 they were concerned about the sufficiency of GATT rules regarding STEs because countries like China and Russia, where the state has a significant economic role, are interested in joining WTO. Some country officials observed that current rules focus on providing transparency, but such provisions alone may not provide effective disciplines. U.S. officials said that the subject of state trading has been prominent during China's WTO accession talks as WTO members attempt to understand the government's economic role and its ability to control trade.

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[6]See State Trading Enterprises: Compliance with the General Agreement on Tariffs and Trade (GAO/GGD-95-208, Aug. 30, 1995).

THE AGREEMENT ON TEXTILES AND CLOTHING

Textiles is one sector where the United States expected losses in jobs and in domestic market share after the Uruguay Round, even though consumers were expected to gain from lower prices and a greater selection of goods. We are currently reviewing how the United States is implementing the Uruguay Round Agreement on Textiles and Clothing, which took effect in January 1995. The Committee for the Implementation of Textile Agreements (CITA), an interagency committee, is charged with implementing the agreement, which calls for a 10-year phase-out of textile quotas. Because of the 10-year phase-out, the effects of the textiles agreement will not be fully realized until 2005, after which textile and apparel trade will be fully integrated into WTO and its disciplines. This integration is to be accomplished by (1) completely eliminating quotas on selected products in four stages and (2) increasing quota growth rates on the remaining products at each of the first three stages. By 2005, all bilateral quotas maintained under the agreement on all WTO member countries are to be removed.

The agreement gives countries discretion in selecting which products to remove from quotas at each stage. During the first stage (1995 through 1997), almost no products under quota were integrated into normal WTO rules by the major importing countries. The United States is the only major importing country to have published an integration list for all three stages; other countries, such as the EU and Canada, have only published their integration plan for the first phase. Under the U.S. integration schedule, 89 percent of all U.S. apparel products under quota in 1990 will not be integrated into normal WTO rules until 2005. CITA officials pointed out that the Statement of Administrative Action accompanying the U.S. bill to implement the Uruguay Round agreements provided that "....integration of the most sensitive products will be deferred until the end of the 10-year period."

During the phase-out period, the textiles agreement permits a country to impose a quota only when it determines that imports of a particular textile or apparel product are harming, or threatening to harm, its domestic industry. The agreement further provides that the imposition of quotas will be reviewed by a newly created Textiles Monitoring Body consisting of representatives from 10 countries, including the United States.

The United States is the only WTO member country thus far to impose a new quota under the agreement's safeguard procedures. In 1995, the United States requested consultations with other countries to impose quotas on 28 different imports that CITA found were harming domestic industry. The Textiles Monitoring Body has reviewed nine of the U.S. determinations to impose quotas (where no agreement was reached with the exporting country) and agreed with the U.S. determination in one case. In three cases, it did not agree with the U.S. decision, and the United States dropped the quotas. It could not reach consensus in the other five cases it reviewed. In 15 of the remaining 19 decisions, the United States either reached agreement with the exporting countries or dropped the quotas. Four cases are still outstanding.

ONGOING NEGOTIATIONS AND THE FINANCIAL SERVICES AGREEMENT

Another area that warrants tracking by policymakers is the General Agreement on Trade in Services (GATS), an important new framework agreement resulting from the Uruguay Round. Negotiations on financial, telecommunications, and maritime service sectors and movement of natural persons were unfinished at the end of the round and thus postponed. Each negotiation was scheduled to be independent from the other ongoing negotiations, but we found that they do in fact affect one another.

In 1995, we completed a preliminary review of the WTO financial services agreement, which was an unfinished area in services that reached a conclusion. The agreement covers the banking, securities, and insurance sectors, which are often subject to significant domestic regulation and therefore create complex negotiations. In June 1995, the United States made WTO commitments to not discriminate against foreign firms already providing financial services domestically. However, the United States took a "most-favored-nation exemption," that is, held back guaranteeing complete market access and national treatment to foreign financial service providers. (Doing so is allowed under the GATS agreement.) Specifically, the U.S. commitment did not

include guarantees about the future for new foreign firms or already established firms wishing to expand services in the U.S. market. Despite consistent U.S. warnings, the decision to take the exemption surprised many other countries and made them concerned about the overall U.S. commitment to WTO. The U.S. exemption in financial services was taken because U.S. negotiators, in consultation with the private sector, concluded that other countries' offers to open their markets to U.S. financial services firms, especially those of certain developing countries, were insufficient to justify broader U.S. commitments (with no most-favored-nation exemption).[7]

The effect of the U.S. exemption may go beyond the financial services negotiations. According to various officials in Geneva, foreign governments are wary of making their best offers in the telecommunications service negotiations, for fear that the United States would again take a significant exemption in these talks. Nevertheless, three-quarters of the participating countries have made offers, and the telecommunications talks are continuing toward the April 30 deadline. However, U.S. and foreign government officials have expressed concern regarding the quality of offers made and the fact that some key developing countries have not yet submitted offers.

Despite the commitments that all parties made regarding market access and equal treatment in the financial services sector, several U.S. private sector officials told us that the agreement itself did little to create greater access to foreign markets. Still, the benefit from such an agreement results from governments making binding commitments (enforceable through the dispute settlement process) that reduce uncertainty for business. Monitoring foreign government implementation of commitments is important to ensure that the United States will receive the expected benefits. At the end of 1997, countries, including the United States, will have an opportunity to modify or withdraw their commitments. Thus, the final outcome and impact of the financial services agreement are still uncertain.

DISPUTE SETTLEMENT IMPLEMENTATION

According to the WTO Dispute Settlement Understanding, the dispute settlement regime is important because it is a central element in providing security and predictability to the multilateral trading system. Members can seek the redress of a violation of obligations or other nullification or impairment of benefits under the WTO agreements through the dispute settlement regime. The objective of this mechanism is to secure a "positive solution" to a dispute. This may be accomplished through bilateral consultations even before a panel is formed to examine the dispute. The vast majority of international trade transactions have not been the subject of a WTO dispute. According to recent WTO figures, in 1994 the total value of world merchandise exports was $4 trillion and commercial service exports was $1 trillion. WTO reports that its membership covers about 90 percent of world trade. However, 25 disputes have been brought before WTO between January 1, 1995, and January 16, 1996.

As we previously reported, the former GATT dispute settlement regime was considered cumbersome and time-consuming.[8] Under the old regime, GATT member countries delayed dispute settlement procedures for months and, sometimes, years. In 1985, we testified that the continued existence of unresolved disputes challenged not only the principles of GATT but the value of the system itself.[9] We further stated that the member countries' lack of faith in the effectiveness of the old GATT dispute settlement mechanism resulted in unilateral actions and bilateral understandings that weakened the multilateral trading system.

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[7]However, the United States was generally satisfied with the offers made by the EU, Japan, and other developed countries.

[8]See International Trade: Combating Unfair Foreign Trade Practices (GAO/NSIAD-87-100, Mar. 17, 1987) and The International Agreement on Government Procurement: An Assessment of Its Commercial Value and U.S. Government Implementation (GAO/NSIAD-84-117, July 16, 1984).

[9]See United States Participation in the Multilateral Trading System, statement by Allan I. Mendelowitz, GAO, before the U.S. Senate, Subcommittee on International Economic Policy, Oceans and Environment, Committee on Foreign Relations (Sept. 26, 1985).

The United States negotiated for a strengthened dispute settlement regime during the Uruguay Round. In particular, the United States sought time limits for each step in the dispute settlement process and elimination of the ability to block the adoption of dispute settlement panel reports. The new Dispute Settlement Understanding establishes time limits for each of the four stages of a dispute: consultation, panel, appeal, and implementation. Also, unless there is unanimous opposition in the WTO Dispute Settlement Body, the panel or appellate report is adopted. Further, the recommendations and rulings of the Dispute Settlement Body cannot add to or diminish the rights and obligations provided in the WTO agreements. Nor can they directly force countries to change their laws or regulations. However, if countries choose not to implement the recommendations and rulings, the Dispute Settlement Body may authorize trade retaliation.

As previously mentioned, there have been a total of 25 WTO disputes. Of these, the United States was the complainant in six and the respondent in four. In comparison, Japan was a respondent in four disputes and the EU in eight.[10] All the disputes have involved merchandise trade. The Agreements on Technical Barriers to Trade and the Application of Sanitary and Phytosanitary Measures have been the subject of approximately half the disputes. In January 1996, the first panel report under the new WTO dispute settlement regime was issued on the "Regulation on Fuels and Fuels Additives - Standards for Reformulated and Conventional Gasoline." Venezuela and Brazil brought this dispute against the United States. The panel report concluded that the Environmental Protection Agency's regulation was inconsistent with GATT. The United States has appealed this decision.

Based on our previous work on dispute settlement under the U.S.-Canadian Free Trade Agreement (CFTA),[11] it may be difficult to evaluate objectively the results of a dispute settlement process. It may takes years before a sufficiently large body of cases exists to make any statistical observations about the process. After nearly 5 years of trade remedy dispute settlement cases under CFTA, there were not enough completed cases for us to make statistical observations with great confidence.[12] Specifically, we were not able to come to conclusions about the effect of panelists' backgrounds, types of U.S. agency decisions appealed, and patterns of panel decisionmaking.

FUTURE WTO ENDEAVORS

WTO members must wrestle with three competing but interrelated endeavors in the coming years. Implementation, accession of new member countries, and bringing new issues to the table will all compete for attention and resources. The first effort, which we have already discussed, involves implementing the Uruguay Round agreements. It will take time and resources to (1) completely build the WTO organization so that members can address all its new roles and responsibilities; (2) make members' national laws, regulations, and policies consistent with new commitments; (3) fulfill notification requirements and then analyze the new information; and (4) resolve differences about the meaning of the agreements and judge whether countries have fulfilled their commitments. The importance of implementation was underscored by U.S. Trade Representative and Department of Commerce announcements earlier this year that they were both creating specific units to look at foreign government compliance with trade agreements, including WTO.

The second effort is the accession of new countries to join WTO and to undertake GATT obligations for the first time. The accession of new members will present significant economic and political challenges over the next few years. Even though, as mentioned earlier, WTO members account for about 90 percent of world trade, there are many important countries still outside the GATT structure. The 28 countries that applied for WTO membership as of December 1995 included China, the Russian Federation, Viet Nam, and countries in Eastern Europe. These

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[10]Japan was a complainant in one dispute and the EU in two.

[11]See U.S.-Canada Free Trade Agreement: Factors Contributing to Controversy in Appeals of Trade Remedy Cases to Binational Panels (GAO/GGD-95-175BR, June 16, 1995).

[12]Between 1989 and September 1994, there were 15 completed cases that involved U.S. agency determinations.

countries will be challenged in undertaking WTO obligations and fulfilling WTO commitments as current WTO members are themselves challenged by the additional responsibilities created by the Uruguay Round agreements. Many of these countries are undergoing a transition from centrally planned to market economies. The negotiations between current WTO members and those hoping to join are very complex and sensitive since they involve such fundamental issues as political philosophy.

The third effort is negotiating new areas. In December 1996, a WTO ministerial meeting is to take place in Singapore. This is to be a forum for reviewing implementation of the Uruguay Round agreements and for negotiating new issues. Some foreign government and WTO officials told us that they hope these regularly scheduled, more focused WTO ministerial meetings will replace the series of multiyear, exhaustive negotiating "rounds" of the past. However, other officials expressed doubt that much progress could be made toward future trade liberalization without the pressure created by having a number of important issues being negotiated at one time. Nevertheless, any negotiations will require time and resources.

Members are debating whether to (1) push further liberalization in areas already agreed to, but not yet fully implemented; and/or (2) negotiate new issues related to international trade. For example, future WTO work could include examination of national investment and competition policy, labor standards, immigration, and corruption and bribery. Some of these negotiations in new areas could be quite controversial, based on the experience of including areas like agriculture and services in the Uruguay Round negotiating agenda.

Issues relating to the Singapore ministerial are currently under debate. This could be an opportunity for Congress to weigh the benefit of having U.S. negotiators give priority to full implementation of Uruguay Round commitments, as opposed to giving priority to advocating new talks on new topics. The first priority seeks to consolidate accomplishments and ensure that U.S. interests are secured; the latter priority seeks to use the momentum of the Uruguay Round for further liberalizations.

Thank you, Mr. Chairman, this concludes my prepared remarks. I will be happy to answer any questions you or the Subcommittee may have.

Chairman CRANE. Thank you very much, Ms. Hecker.

Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman. Ladies and gentlemen, good to be with you. I have a couple of questions. First of Ms. Hecker. You talked in your testimony about the notification requirements. It just seems to me when you have over 200 notification requirements that something has gone off the tracks here.

One of the problems when you are in business, as I am sure you know, is that many times you have a good case but you cannot get it heard because the complications and the bureaucratic stumbling blocks are so great. What are you doing—you say WTO members have formed a working party. Is that having any success at all?

Ms. HECKER. They are looking at trying to consolidate some of the requirements, but they are really very necessary. One key one is in agriculture that I mentioned. Countries basically have a requirement to file the new policies they are implementing and to demonstrate they are in compliance with the detailed provisions. That really is the basic core of complying with the agreement, and you would not want to say, Gee, that is an extra burden, let's not impose that kind of requirement.

The real problem has been with the developing countries frankly, and also some of the sensitivities that have been behind some of the filings. I know the United States, for example, was under pressure to declare the CCC, the Commodity Credit Corp., as a State trading enterprise, and there were delays in the filings by the United States of whether they really felt it met the definition and whether they would declare the CCC was in fact a State trading organization.

So I think most of them have substantial justification as a necessary tool to implement the agreement, and I think this focus on trying to make them as efficient as possible is probably an appropriate addition to that.

Mr. HOUGHTON. I have another question. Mr. Schott and Mr. Destler, I am sorry I was not here for your testimony. I would like to ask Mr. Cobb this, but if you would like to chime in, that would be great.

The WTO, I think, is an enormously important organization, because the United States being the largest market, and our market being the most precious economic asset we have, we had no place to go. I may have misunderstood you, but I think you were saying that obviously the WTO is against discrimination. So to offset discrimination, you can have defensive discrimination on the part of another country. Did I understand that correctly? And if that is so, I would think this would be awfully hard to administer. Maybe you could break that down a little bit.

Mr. COBB. No, sir. In my written testimony I went into some greater detail talking about how this process works. It is a very important procedure. The parties all commit themselves not to discriminate with the most favored nation and the national treatment rules. But because as politics inside each country is, as you are so familiar, the interest groups, the constituents want some special treatment oftentimes, and the legislative and executive bodies give in. This is natural.

But what is a trading partner to do? What is the response? Without a moderating organization such as the WTO, the response is normally the slow escalation of trade barriers, trade wars, and things that we used to see before 1929 when countries were imposing tariffs against each other. But in the WTO, the rule is very specific. First, there is the arbitration that looks at all the facts and has the appeal process which determines if there is a discrimination. It is important to get the facts on the table and to look at them.

If it is true there is a discrimination, then the other party, usually in the case of a single other party—although in the case of Venezuela and Brazil, Brazil asked for and was granted a joining of that panel. So it was two against us. Their remedy is to say, OK, the United States has been found to be discriminating in this very small, narrow degree. They will be granted the right to do likewise. It is the same sanction you would have in a game where if the other party is cheating, you stop playing with them. Except it works better than that because the degree of offset is measured, moderated, arbitrated, it is equal, and it is small.

But the political process then kicks back in because some Americans that want to do business in Venezuela or Brazil find they are discomforted by whatever sanction Venezuela or Brazil would be permitted to adopt. And they would come to Congress and ask Congress to fix the original problem with petroleum.

Mr. HOUGHTON. Let me just—could I have just 1 minute more, Mr. Chairman?

Chairman CRANE. Sure.

Mr. HOUGHTON. I would like to follow this up to bring it right down to home and to give you a specific example. Kodak is having this terrible problem in Japan. So you would expect the World Trade Organization to allow the United States, through the enforcement of its trade laws, to eliminate any imports of Japanese films until that situation had been cleared?

Mr. COBB. No, the World Trade Organization's role in this case would be first to find out the facts that Kodak Corp. has alleged to be true.

Mr. HOUGHTON. I understand. Let's say all the facts are found out and they agree with Kodak, just as an example.

Mr. COBB. And then to reach a considered judgment as to how much economic loss might have been inflicted upon the Kodak Corp. by the Japanese practices. And then to permit the United States to propose some offsetting sanction that would have an equivalent economic value. It might not involve film at all. It might involve automobile parts. It might involve some service. It might involve electronics.

But it would be something the United States would propose and would negotiate with Japan. The World Trade Organization would act as an intermediary to look and see what the proposals were, and to reach the judgment that it was an equal, offsetting economic value. Then that would remain in place as long as the discrimination persisted. Hopefully, the process would then go another step through the domestic political process of both the United States and Japan and undo the original discrimination that was found to exist.

Mr. HOUGHTON. It sounds good. It sounds a little complicated. Having lived through these things myself, many times it is suiting action to the word. The intellectual concept is there, but many times it gets tied up.

If I could interrupt just 1 minute more. Maybe Mr. Schott or Mr. Destler would like to make a comment. Would that be all right, Mr. Chairman?

Chairman CRANE. Yes.

Mr. SCHOTT. Let me try to say it rather simply, even though it is a complex issue. Nondiscrimination covers a great deal of world trade rules but not all. It covers the areas that are subject to the trading rules, primarily the merchandise trade. The primary remedy when there is a violation of the nondiscrimination rule is not to revoke it, but rather to seek some sort of accommodation in terms of further liberalization. So the country that is violating the agreement makes up for it by further liberalization. The retaliation which Mr. Cobb is talking about is really the last resort.

Now in the case of Kodak, the problem is more complicated because the key issue under dispute is not covered primarily by the international trading rules. It deals with the antitrust issues within the economy. This is why it is so important we begin to address these types both bilaterally, regionally, and in the multilateral system. If we have a complaint and we feel our rights have been violated, we can take action against Japan, but it would have to be in areas not covered by our current trade obligations. So that would be a quite limited area where we could retaliate.

Mr. DESTLER. Let me just add briefly to that. This broad area is sometimes called competition policy or what is fair pricing, what is fair marketing, fair control of the market within a country. It is kind of a gray area in trade policy and one of the reasons why a number of people, including, I think, Mickey Kantor, have proposed that this subject be given attention and priority in ongoing or future trade negotiations, because these might establish some rules by which a Kodak or a company in a similar circumstances might be able to go directly to the WTO rather than going through the section 301 which cannot, by itself, win us a clear international judgment on the rightness of our case.

Mr. HOUGHTON. I would say one more thing, Mr. Chairman. I just hope we are going to be able to have some sort of fast, easy, straightforward, understandable remedy out of the World Trade Organization, because if not we are going to end up with a warehouse for goods we cannot afford to buy, and that is not very good.

So thank you very much.

Chairman CRANE. I want to thank all of you for your participation today and reassure you, your complete statements will be a part of the permanent record.

Thank you.

Let me call our next panel, Dr. Peter Richardson, senior assistant general counsel and general patent counsel, Pfizer, Inc., on behalf of the Intellectual Property Committee; Eric Smith, president, Intellectual Property Alliance; Bob Vastine, president, Coalition of Services Industries. Howard Lewis was unable to be with us. He is vice president for trade and technology policy with the National

Association of Manufacturers. But his full statement will be a part of the record.

As I have mentioned before, if you folks can condense your presentations to 5 minutes, we will guarantee your full statements will be a part of the permanent record.

Dr. Richardson, you might proceed first, and we will take you gentlemen in order.

STATEMENT OF PETER C. RICHARDSON, SENIOR ASSISTANT GENERAL COUNSEL AND GENERAL PATENT COUNSEL, PFIZER, INC.; ON BEHALF OF INTELLECTUAL PROPERTY COMMITTEE

Mr. RICHARDSON. Mr. Chairman, and Members of the Subcommittee, I appreciate your invitation to provide the views of IPC, the Intellectual Property Committee, on the implementation of the TRIPs Agreement.

The IPC's long support for the negotiation of the TRIPs and NAFTA Agreements and our continuing search for improved worldwide intellectual property protection stem from the link between intellectual property protection and American competitiveness and job growth.

Our most internationally competitive industries depend on intellectual property protection. For example, the computer software, motion picture, sound recording, pharmaceutical, chemical, and electronic industries are among the largest and fastest growing segments of the U.S. economy. Employment in these industries grew at close to four times the rate of employment in the economy as a whole between 1983 and 1993. Furthermore, the foreign sales of these industries make major positive contributions to the U.S. balance of payments.

Current U.S. policy on intellectual property, which is contained in the intellectual property objectives of the Uruguay Round Agreements Act that were crafted by this Subcommittee, calls not only for the acceleration of TRIPs implementation but also for the implementation of intellectual property standards that go beyond those contained in TRIPs. These objectives reflect the concerns of U.S. industry about the substantive deficiencies and long transition periods of the TRIPs Agreement. They also recognize the emerging nature of technological developments and the need for intellectual property protection to keep pace with such technological change in order to ensure the continued competitiveness of U.S. industry in the world marketplace.

We are faced with a bifurcated situation as we seek to gain improved intellectual property protection abroad. The WTO multilateral consultation and dispute settlement procedures will provide the vehicle for gaining improved protection in the developed countries, which have been obligated since January 1, 1996, to provide TRIPs level protection, while bilateral and regional efforts will, for the most part, continue to be the only vehicles for gaining the improved protection in the developing countries, the least developed countries, and countries that are not members of the WTO.

Currently, we face implementation problems in Japan with respect to sound recordings; Portugal with respect to existing patents, in the United Kingdom with respect to compulsory licenses,

and in Australia with respect to proprietary information. The TRIPs implementation issues raised by these cases are not unique. A swift and concerted U.S. response in the WTO will not only deal with the problems in the target countries, but will also send a clear message to the other developing as well as developed countries that their similar TRIPs-inconsistent practices will also be challenged by the United States.

For the most part, the developing countries are not subject to WTO discipline. The one major exception is TRIPs article 70.8, the so-called mailbox provision. While we remain concerned the expedited commercial benefits theoretically envisaged by the mailbox provision and its companion provision, article 70.9, will never materialize in practice, implementation of the mailbox provision is a critical first step which is enforceable in the WTO.

The long TRIPs transition periods are forcing us to look outside the WTO for instruments to gain improved intellectual property protection in the developing countries. These countries are by no means small markets, and the continued lack of effective intellectual property protection in such markets as China, Argentina, Brazil, and Turkey, to name but a few, is very damaging to U.S. commercial interests.

Our experience with bilateral intellectual property agreements, for example with Korea and China, demonstrates that, all things being equal, developing countries will not undertake any improvements in their intellectual property standards and enforcement until after the transition periods are over. To avoid facing the same situation with respect to the TRIPs transition periods, we will need to undertake a concerted effort to ensure the developing countries have good protection and are on their way to implementing effective enforcement by the end of the transition periods.

The United States must ensure adequate intellectual property protection is extended to biotechnological inventions, which were not fully covered in the current multilateral agreements, and to digitized works and the content creators who will be asked to put their works on the global information infrastructure. It goes without saying the United States must ensure the current levels of intellectual property protection are not whittled away in multilateral fora outside of the WTO.

As the expected standards of intellectual property protection begin to improve, new intellectual property related issues, such as the cost of patent acquisition and maintenance, and the scope of patent protection, have emerged. The potential benefits from improved protection will become quickly dissipated by these skyrocketing costs and patent practices not covered by TRIPs unless we begin to deal with these problems.

Thank you.

[The prepared statement follows:]

STATEMENT OF PETER C. RICHARDSON
SENIOR ASSISTANT GENERAL COUNSEL
AND GENERAL PATENT COUNSEL, PFIZER, INC.
ON BEHALF OF INTELLECTUAL PROPERTY COMMITTEE

I am Peter C. Richardson, Senior Assistant General Counsel and General Patent Counsel of Pfizer Inc. I appreciate your invitation to provide the views of the Intellectual Property Committee (IPC) on the implementation of the TRIPS Agreement. My testimony today will focus on two issues: (1) the IPC's assessment of the current state of TRIPS implementation; and (2) the broader question of how to ensure that we continue to make gains in improving the worldwide protection of intellectual property.

The views of the IPC on the TRIPS Agreement are known to this Subcommittee. In November, 1993 C.L. Clemente of Pfizer provided the IPC's views on the draft TRIPS (Dunkel) text immediately preceding the final round of GATT negotiations in Geneva; and in February, 1994, Timothy Hackman of the IBM Corporation described in some detail to this Subcommittee the IPC's reaction to the final version of the TRIPS Agreement. I do not want to repeat their testimony, but I believe that, before any discussion of TRIPS implementation can take place, it is important to briefly provide our general assessment of the agreement itself.

The IPC was formed in March, 1986--six months before the Punta del Este Ministerial Meeting that launched the Uruguay Round--with the specific mission of mobilizing domestic and international support for the negotiation of an intellectual property agreement in the GATT. The members of the IPC--General Electric, Hewlett-Packard, IBM, Johnson & Johnson, Merck, Microsoft, Pfizer, Procter & Gamble, Rockwell International, Texas Instruments and Time Warner--represent the broad spectrum of private sector U.S. intellectual property interests. In June, 1988, the IPC achieved a significant milestone when it reached a tripartite consensus with the Keidanren, representing Japanese industry, and UNICE, representing European industry, on how the GATT should deal with intellectual property in the Uruguay Round negotiations. The 100 page report defined in detail the minimum standards for ensuring fundamental protection for all categories of intellectual property and proposed procedures for enforcing that protection. The IPC continues to collaborate closely with our private sector counterparts abroad in support of our mutual objective of strong worldwide intellectual property protection.

Senior management of the IPC member companies worked very closely with U.S. negotiators and the Congress--especially with members of this Subcommittee and their staffs--and with our private sector counterparts in Europe and Japan to develop a GATT agreement that would contain adequate and effective intellectual property protection. The IPC recognized the substantial progress that had been made in the negotiations and, as a result, supported the TRIPS Agreement and the intellectual property-related provisions of the Uruguay Round Agreements Act.

The IPC's long support for the negotiation of the TRIPS and NAFTA agreements and our continuing search for improved worldwide intellectual property protection stem from the inexorable link between intellectual property protection and American competitiveness and job growth. America's competitive edge rests ultimately on our creativity and resourcefulness--the unique ability of Americans to generate new ideas and develop new ways of looking at the world. Our most internationally-competitive industries depend on intellectual property protection: for example, the computer software, motion picture, sound recording, pharmaceutical, chemical and electronic industries are among the largest and fastest growing segments of the U.S. economy. Employment in these industries grew at close to four times the rate of employment in the economy as a whole between 1983 and 1993. Furthermore, the foreign sales of these industries make major positive contributions to the U.S. balance of payments.

In stressing the importance of the intellectual property-dependent industries to the U.S. economy, I underline the IPC's concern that policy makers in the United States and in our trading partners not fall into the trap of thinking that implementation of the TRIPS Agreement will by itself solve the intellectual property problems that we are facing today. Should policy makers adopt this view, technology-exporting countries will be taking a major economic risk, because the resultant loss of intellectual property protection abroad will endanger the future commercial health of those industries that have had a demonstrated track record of making positive contributions to economic and commercial activity.

Our endorsement of the TRIPS Agreement was predicated, at the time, on the generally high standards of protection and enforcement for patents, copyrights, trademarks, trade secrets, industrial designs and semiconductor layout designs that were contained in the agreement and the limitations that were put by the agreement on many of the exceptions and derogations from the standards of protection that were of concern to the IPC. The fact that TRIPS included a multilateral dispute resolution mechanism was also a critical factor in our decision to support the final agreement.

At the time, however, we also expressed our disappointment at the deficiencies in protection that were contained in TRIPS. These included:

- Overly long and discriminatory transition periods before the developing countries (LDCs) have to undertake their obligations. The generally adequate and effective standards of intellectual property protection contained in the TRIPS Agreement have been of little immediate help to U.S. industry, since the agreement provides the developing countries with a "legal cover" to delay for five to ten years the implementation of TRIPS level protection. One of the major instruments on which U.S. industry had been counting to resolve disputes--the WTO multilateral consultation and dispute settlement mechanism--is not available to us during this period to gain the improved intellectual property protection that we were seeking through the negotiation of the TRIPS Agreement.

- Ambiguities in the copyright provisions regarding the provision of full national treatment to all intellectual property rightholders. These ambiguities have resulted in exceptions to the cardinal trade principle of "national treatment," which will permit WTO Members to argue that their discrimination against U.S. national is permitted under TRIPS.

- Five-year moratorium on the application of the "nullification and impairment" provisions to TRIPS. This moratorium may adversely affect our ability to reap early commercial benefits from TRIPS in the industrialized countries, which, for the next four years, are only obligated to implement the "letter" of the TRIPS Agreement and not its "spirit."

In addition, the TRIPS Agreement contains a number of deficiencies, the most glaring of which is the absence of adequate patent protection for biotechnological inventions and for existing subject matter under TRIPS Article 70(9).

The Current Environment for Intellectual Property Protection

The current intellectual property situation is very complicated. Current U.S. policy on intellectual property, which is contained in the intellectual property objectives of the Uruguay Round Agreements Act that were crafted by this Subcommittee, calls not only for the acceleration of TRIPS implementation but also for the implementation of intellectual property standards of protection and enforcement that go beyond those contained in TRIPS. These objectives, which have come to be known respectively as "TRIPS implementation" and "TRIPS plus," reflect the concerns of U.S. industry about the substantive deficiencies and long transition periods of the TRIPS Agreement that I have just described. They also recognize the emerging nature of technological developments and the need for intellectual property protection to keep pace with such technological change in order to ensure the continued competitiveness of U.S. industry in the world market place. The issue before this Subcommittee today--TRIPS implementation--is thus but one consideration in the ongoing drive of U.S. industry to gain improved worldwide intellectual property protection.

The international environment in which that search will take place is now set for the next four to nine years. Unless the WTO Ministerial Meeting, which is scheduled for Singapore in December, agrees to an acceleration of the TRIPS transition provisions, developing countries will not be under any WTO obligation to implement their TRIPS obligations until the year 2000, and, in some cases, until the year 2006.

We are thus faced with a bifurcated situation as we seek to gain improved intellectual property protection abroad: (1) the WTO multilateral consultation and dispute settlement procedures will provide the vehicle for gaining improved protection in the developed countries, which have been obligated since January 1, 1996 to provide TRIPS level protection; and (2) bilateral and regional efforts will, for the most part, continue to be the only vehicles for gaining the improved protection in the developing countries, the least developed countries and countries that are not members of the WTO.

Another complicating factor in the current international environment are the alternative models for intellectual property protection contained in the NAFTA and in the bilateral agreements negotiated by the United States. Quite often--and, especially, in the case of NAFTA--the standards of protection contained in these agreements are higher than those found in TRIPS. Thus, in reviewing the current state of TRIPS implementation in primarily the developed countries, we must recognize that we are also engaged in a parallel "TRIPS acceleration/plus" exercise in many other countries of the world.

One other element affecting the current environment for worldwide intellectual property protection is our attitude towards intellectual property protection here in the United States. The United States was the principal leader in the negotiation of the TRIPS Agreement and continues to be the leading proponent for accelerated and improved intellectual property protection. What we do and say here in the United States is watched very closely by opponents of strong intellectual property protection abroad. As the principal source of creative and inventive activity, the United States stands to benefit most from proper TRIPS implementation and elevated standards of intellectual property protection around the world. We must make sure that our official statements and actions with respect to our own TRIPS implementation or on what may appear to be purely domestic intellectual property issues do not send the wrong signal to other governments about our commitment to strong intellectual property protection. We must avoid at all costs undermining our international quest for strong intellectual property protection by setting dangerous precedents here in the United States that intellectual property opponents overseas will throw back at us.

The Current State of TRIPS Implementation

It is safe to say that the question of TRIPS implementation at this point in time and in the absence of TRIPS acceleration is for the most part a developed country issue. Developing countries are not breaking down the doors of the WTO in Geneva and volunteering to implement their TRIPS obligations prior to the end of the transition periods permitted under TRIPS Article 65.

The TRIPS Agreement, however, is having an effect on the nature of the bilateral exchanges that both the U.S. Government and industry are having in many developing countries, especially in the newly industrializing countries of Latin America, Asia and the former Soviet Union. TRIPS has become the standard for adequate and effective intellectual property protection against which countries are measuring their protection. While, in many cases, we believe that the advanced developing countries should be considering higher standards than TRIPS, nevertheless the use of TRIPS vocabulary is most welcome.

There, however, is a very critical, evolving danger in the use of TRIPS and that is the trend that we are already seeing for some developing country governments to enact TRIPS-inconsistent laws and then hailing them as TRIPS-consistent. Failure to challenge publicly these laws will lend support to inaccurate assertions of TRIPS-consistency. The net result will be a proliferation of bad laws that will call into question the benefits that U.S. industry has the right to expect from the TRIPS Agreement. This, in turn, will undermine the WTO.

As I have indicated, the developed country members of the WTO have been obligated to implement TRIPS since January 1, 1996. Even before then, the IPC had been collecting information on the changes that developed countries would be required to make in their laws and regulations to conform to TRIPS. We have worked very closely with our private sector counterparts abroad and have provided our findings to the Administration. The conventional wisdom during the negotiation of the TRIPS Agreement had been that the developed countries would not have to make major changes in their intellectual property laws and regulations and that, like the United States in the URAA, they would make the necessary changes openly and during the one-year transition period provided by TRIPS.

What we have found, however, is that this has not always been the case. For the most part, our trading partners have addressed the general question of TRIPS conformity, but, in critical areas, have failed to make the requisite changes in their domestic laws and regulations. The adverse commercial implications for U.S. rightholders of these failures to conform to TRIPS are significant. The IPC has urged the Administration to be aggressive in using the WTO consultation and dispute settlement procedures to bring our concerns to the attention of our trading partners.

The following cases are illustrative of the types of implementation issues that we face in the developed countries and are by no means exhaustive:

- Japan has failed to protect sound recordings originating in the United States and created on or after January 1, 1946 as it is required by TRIPS. Japan only protects such recordings created after January 1, 1971, and on February 9th Ambassador Kantor announced the initiation of WTO dispute settlement proceedings against Japan. While we understand that Japan has indicated its willingness to make the necessary changes, many details still remain unsettled. This case is critical not only in its own right but also because a number of other WTO members have not fulfilled their obligation to protect properly older works and/or sound recordings.

- Portugal is required to extend the terms of all 15 year patents that were in force on January 1 1996 under the same TRIPS provision [Article 70(2)] that required the United States to extend the patent terms of its existing 17 year patents. Significant U.S. commercial interests are at stake: some 15-year Portuguese patents belonging to U.S. persons are about to expire and will fall into the public domain unless Portugal begins to respect its TRIPS obligations by providing the longer patent term. It is important to note that another member state of the European Union, Greece, when faced with the similar problem, provided the patent term extension.

- The United Kingdom's current patent law does not recognize importation from other WTO members as meeting the local working requirement for compulsory licensing purposes as required by TRIPS Article 27(1). British Government officials insist that changes are not needed in the patent law, because the compulsory licensing provision has been superseded by the United Kingdom's accession to the GATT Uruguay Round. Nevertheless, there is no guarantee that a British judge deciding a patent compulsory license case will be prepared to look beyond the patent law. More significantly, its presence in the British patent law has major third country implications. Developing countries will be looking at the changes that the United Kingdom and other EU member states will be introducing in their intellectual property laws before making their own changes. In addition, Portugal, Italy and Spain have similar compulsory licensing provisions in their laws and could grant such licenses even if their markets were being served through importation from another WTO country. Both France and Greece, which had similar compulsory licensing provisions on their books, changed their patent laws to conform to the TRIPS requirement.

- Australia does not provide protection against the unfair commercial use of safety and efficacy data submitted to the Australian Government for gaining marketing approval of agrochemical and pharmaceutical products. As a result, Australia is in violation of its TRIPS obligations under Article 39(3). Patent holders spend millions of dollars on the development of this proprietary data, which in the United States and Western Europe are fully protected.

The TRIPS implementation issues raised by these cases are not unique and a swift and concerted U.S. response will not only deal with the problem in the target country but will also send a clear message to the other--developing as well as developed--countries that their similar TRIPS-inconsistent practices will also be challenged by the United States. In this regard, we congratulate Ambassador Kantor for his swift use of the WTO dispute settlement procedures against Japan on sound recordings and strongly support his decision to challenge Canada's discriminatory practices that severely disadvantage U.S. copyright-dependent industries in the Canadian market.

As I indicated earlier, for the most part, the developing countries are not subject to WTO discipline. The one major exception is TRIPS Article 70(8),the so-called "mailbox provision," which requires countries that do not provide patent protection for pharmaceuticals and agricultural chemicals to establish a mechanism for filing patent applications as of the date that the TRIPS Agreement went into effect, that is, January 1, 1995. Brazil, India, Turkey, Tunisia, Uruguay, Paraguay, Egypt, Cuba and Argentina have notified the WTO that they have established the mailbox, while Pakistan and Kuwait were recently singled out by the United States for not yet implementing the mailbox. While we remain concerned that the expedited commercial benefits theoretically envisaged by the mailbox provision and its companion provision, Article 70(9), will never materialize in practice, implementation of the mailbox provision is a critical first step, which is enforceable by the WTO dispute settlement procedures.

Other Approaches to Gaining "TRIPS Acceleration/Plus"

Bilateral Approaches

Unfortunately, the TRIPS Agreement did not define a process for identifying those developing countries that are eligible to avail themselves of the 5 and 10 year transition periods. The resultant self-selection process, with all developing countries so far choosing "developing country" status, is forcing us to look outside the WTO for instruments to gain improved intellectual property protection in those countries. These countries are by no means small markets and the continued lack of effective intellectual property protection in such markets as China, Argentina, Brazil and Turkey--to name but a few--is very damaging to U.S. commercial interests.

The current intellectual property situation in Argentina is a case in point. It is increasingly apparent that Argentina is not meeting the intellectual property commitments that officials at the

highest level of the Argentine Government had repeatedly made to the United States since before the conclusion of the TRIPS negotiations. Protection for all intellectual property, as defined by the amalgam of presidential decrees, statutes and recent court decisions, is not improving.

As the PTO recently pointed out, in some respects it is actually worsening. Patent protection is not at all provided for computer programs and is delayed for five years for pharmaceutical products. The compulsory licensing provisions currently in force are so sweeping as to negate any certainty of protection for issued patents and the protection afforded trade secrets falls far short of the effective protection called for in TRIPS. The copyright protection for computer programs required by the 1994 Argentine decree and TRIPS has now been called into question by a recent high court decision declaring that computer programs are not literary works nor subject to authors' rights protection.

The repercussions of the worsening situation in Argentina are particularly troublesome for the Administration's commitment to improving worldwide intellectual property protection. If Argentina is able to flout its obligations to provide adequate and effective intellectual property protection, the progress that the Administration has generated in neighboring Brazil and in sensitive negotiations with such countries as Egypt and Turkey may be derailed.

Another source of concern for the IPC is the fact that the term "transition period" that is used in the TRIPS Agreement is a misnomer. There are no TRIPS provisions that require the developing countries to gradually implement the agreement over the span of the transition period. Rather, they are allowed to delay, with the exception of the national treatment and MFN obligations, implementation of their TRIPS obligations for five to ten years. As a result, the five to eleven year transition periods permitted under TRIPS actually become de facto transition periods of ten to fifteen years.

Our experience with bilateral intellectual property agreements--for example, with Korea and China--demonstrates that, all things being equal, developing countries will not undertake any improvements in their intellectual property standards and enforcement until after the transition periods are over. The end result has been that the transition periods have extended well beyond the periods specified in the agreements. Indeed, the current copyright controversy with China is on that very point and, even though China is not a WTO member, we are concerned that this "footdragging" model will be replicated in other countries, many of which will be WTO Members. To avoid facing the same situation with respect to the TRIPS transition periods, we will need to undertake a concerted effort to ensure that the developing countries have good protection and are on their way to implementing effective enforcement by the end of the transition periods.

At a minimum, technical assistance should be provided by both U.S. Government and industry to set up the necessary intellectual property-related infrastructure in those countries where the lack of such infrastructure will prevent them from meeting the target dates. In 1994, the IPC worked very closely with the Congress and especially with Congressman Gejdenson to enact legislation that established a program in the U.S. Agency for International Development for developing infrastructure in support of strengthened intellectual property protection in developing countries. We understand that, after a slow start, AID is now working closely with the Patent and Trademark Office in putting together programs aimed at intellectual property infrastructure development.

As the transition periods wind down, more and more countries will be passing laws in order to meet their TRIPS obligations. In many instances, countries will be declaring that these new laws conform to TRIPS, when in fact they do not. Should this happen during the transition periods, WTO dispute settlement panels will not be available to resolve the ensuing disputes. Nevertheless, the United States will have to put these countries, as well as countries that do not make any effort to conform their laws to TRIPS, on notice that their assertions and actions will not go unchallenged.

To meet these challenges, the United States, in conjunction with those of its trading partners that were instrumental in negotiating the TRIPS Agreement, needs to develop a constructive and coherent strategy. If we do not, these challenges may very well overwhelm the proper and timely implementation of the TRIPS Agreement.

Regional Approaches

In addition to meeting the long term objective of ensuring that intellectual property protection keeps pace with technological change, the United States should use its regional free trade initiatives as vehicles for the proper implementation of improved intellectual property

standards of protection and enforcement. Any negotiations aimed at extending NAFTA to third countries should require as a down payment the adoption of the NAFTA standards of intellectual property protection. The terms of reference for intellectual property discussions in APEC and the FTAA should require those participants that do not have high standards of protection to recognize, at a minimum, the TRIPS standards of intellectual property protection and to submit a detailed work program on how they will achieve those standards in the required timeframe.

Finally, the United States should work with the European Union to undertake joint measures in order to gain improved intellectual property protection in third countries. The issue is already on the agenda of the Trans-Atlantic Dialogue and should be aggressively pursued by the United States in future meetings with the EU.

Other Intellectual Property Policy Priorities

The TRIPS Agreement, when measured against our expectations back when the IPC started its efforts over ten years ago, represents a major advance in the worldwide protection of intellectual property. Nevertheless, we must recognize that the agreement's standards reflect the needs of the late 1980s and early 1990s. In addition to ensuring the proper and accelerated implementation of those standards, it is critical that we ensure that intellectual property protection keeps pace with technological change.

The TRIPS and NAFTA agreements, as negotiated documents, failed to include full coverage for all technological sectors, while new intellectual property-related issues have come up since the completion of those agreements. Thus, the United States must ensure that adequate intellectual property protection is extended to biotechnological inventions, which were not fully covered in the current multilateral agreements, and to digitized works as well as to the content creators who will be asked to put their works on the Global Information Infrastructure (GII). It goes without saying that the United States must ensure that the current levels of protection are not whittled away in other fora, whether it be the Berne Protocol/New Instrument negotiations underway in WIPO or the ongoing discussions on intellectual property underway in the Council of Parties to the Biodiversity Convention or in the WTO Committee on Trade and the Environment.

As the expected standards of intellectual property protection begin to improve as a result of the TRIPS, NAFTA and other intellectual property agreements, new intellectual property-related issues will emerge. Already two such issues have come to the fore:

- Cost of the acquisition and maintenance of patents. Today, the overall cost of obtaining and maintaining patents has dramatically increased. One estimate puts the total patent costs, not including translation fees, in the 17 countries of the European Patent Office at over $130,000 while the total costs in Japan, including translation fees, is about $30,000 and in the United States over $14,000. With the proliferation of national patent regimes in the wake of the breakup of the Soviet Union and the expected development of intellectual property regimes in the developing countries, U.S. industry will be facing rising costs of patent acquisition and maintenance as these countries increasingly view these fees as significant sources of foreign exchange. The potential benefits from improved protection will become quickly dissipated by these skyrocketing costs, resulting in the refusal by companies to use the system, with attendant adverse effects on the export performance and competitiveness of U.S. industry.

- Enforcement. Japan has in practice the narrowest system of claim interpretation of any of the leading industrial countries. Japan uses this practice to restrict the scope of Japanese patent claims to the strict wording of the patent claims, and, in many cases, restricts the scope to the actual examples disclosed in the patent's specifications. These narrow interpretation practices, both by the Japanese patent office and Japanese courts, enable companies to make minor changes to other companies' patented products or processes and to obtain multiple patents covering only minor variations over the original invention. Such Japanese patents are then given a scope comparable to the original patented invention thereby providing leverage for cross-licensing at low rates.

Conclusion

This Subcommittee has been one of the leading Congressional proponents of a strong U.S. trade policy on intellectual property. The IPC has worked closely with you in the past during the negotiation of the TRIPS and NAFTA agreements to ensure that the creative genius of

America's cutting edge industries was protected around the world. We have now entered into a new era, one which is characterized as much by the development of new solutions to emerging post-TRIPS issues as by the need to ensure the proper and accelerated implementation of the TRIPS Agreement. The IPC is prepared to work with you as well as with the Administration and our private sector counterparts abroad to make certain that the momentum in favor of strong worldwide intellectual property protection that we achieved over the last ten years is not dissipated as we enter this new era.

Chairman CRANE. Thank you.
Mr. Smith, you are next.

STATEMENT OF ERIC H. SMITH, PRESIDENT, INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE

Mr. SMITH. Thank you, Mr. Chairman. The IIPA is a coalition of eight trade associations which represent the motion picture, music and recording, business and entertainment software, and book and journal publishing industries. What unites all of these industries is their dependence on high levels of copyright protection and enforcement. Virtually all of them earn over half their revenues outside the United States. In 1993 these industries accounted for close to $240 billion in value added to the U.S. economy, or over 3.7 percent of the U.S. GDP. Foreign sales and exports exceeded $45 billion in 1993.

Like the IPC, Mr. Chairman, the IIPA was deeply involved in the TRIPs negotiating process from the beginning. While the agreement is flawed in certain key respects, it holds great promise for reducing the massive losses due to piracy suffered by these critical and highly competitive U.S. industries; losses which we estimate in 1995 alone were between $18 and $20 billion. These losses drain our economy of jobs and revenue and threaten one of this country's most advanced and competitive economic sectors.

Our industries have been fortunate that Congress has provided powerful bilateral trade tools, particularly special 301, which has in the last 12 years brought the vast majority of our trading partners to the point where they provide a level of substantive protection for U.S. copyrighted products close to that required by the TRIPs Agreement. There remain two great challenges, however, for the future in the copyright area: Achieving significant enforcement improvements through aggressive and prompt implementation of the enforcement text in TRIPs, and by ensuring that the level of substantive protection is adequate to meet the new challenge of digital technology.

As has been noted by my colleague, Mr. Richardson, among the most serious deficiencies in the TRIPs Agreement is, in the case of copyright, the 4-year transition period allowed to developing countries. When we appeared before this Subcommittee in 1994 we highlighted 10 countries, including Turkey, Egypt, South Korea, Indonesia, Brazil, and others, all of them WTO members, that in 1993 caused over $1.8 billion in losses to our economy due to copyright theft—due to piracy. In 1994 this loss had escalated to $2 billion.

If these countries insist on taking advantage of their full transition period, the United States will have lost up to $8 billion in these next 4 years. If all WTO members that might do so, did so, these losses would be in the tens of billions of dollars. Mr. Chairman, it is demonstrably in this country's interest to encourage these countries, using the sticks of our bilateral trade tools and whatever carrots we can bring to bear, to accelerate their compliance with these TRIPs obligations, particularly in the area of enforcement. In the Uruguay Round Amendments Act, Congress adopted as negotiating objectives for the administration precisely this obligation.

Among the tools available to promote early adherence to TRIPs standards of protection and enforcement are various U.S. trade preference programs like GSP. We urge Congress to renew the GSP and to improve the operation of the Caribbean Basin Initiative and ATPA, as part of an overall package intended in part to encourage early adherence to these international obligations by these countries. Providing renewed fast track authority would also provide a major incentive to our key trading partners to implement improved IP protection earlier than they otherwise would.

The dispute settlement process will be a powerful tool to secure compliance with TRIPs. We particularly want to applaud Ambassador Kantor for bringing the first TRIPs case so promptly against Japan for its failure to protect pre-1971 United States sound recordings. Japan has agreed to change its law, though the timing and precise substance is not yet known. This will mean hundreds of millions of dollars in new revenue and set a significant precedent for other key countries like South Korea, Turkey, and others, including some key non-WTO members that are seeking WTO entry like Russia, Taiwan, and a few others to correct similar deficiencies in their laws.

While full and prompt implementation of TRIPs and its aggressive enforcement by USTR will have a major impact on piracy losses, it must be remembered that substantive norms were settled in 1990 or earlier. Already technological change threatens to makes TRIPs' substantive standards insufficient to safeguard commerce and copyrighted works in the next years. Pending currently in Congress is critical legislation designed to update our law to meet the challenges of digital technology. IIPA supports the thrust of these bills, H.R. 2441 in the House.

There is also a diplomatic conference going on at the end of this year in WIPO which will mirror this legislation and protect U.S. copyrights in a digital age. This is critical because it is this new technology which will bring increased revenue to the United States in future years.

Thank you very much, Mr. Chairman.

[The prepared statement follows:]

Testimony
of

Eric H. Smith
President
International Intellectual Property Alliance

Representing

The International Intellectual Property Alliance

Before

The Subcommittee on Trade
of
The Committee on Ways & Means
United States House of Representatives

March 13, 1996

Mr. Chairman and distinguished Members of the Subcommittee:

I am Eric H. Smith, President of the International Intellectual Property Alliance ("IIPA"). We greatly appreciate the opportunity to once again present the views of the copyright-based industries on the subject of the GATT/WTO and, in particular on the implementation of the TRIPS agreement (Trade-Related Aspects of Intellectual Property Rights) and the implementation and expansion of the GATS (Services) agreement.

We have had the honor of presenting our views on this general topic on three previous occasions -- in January 1992 following the issuance of the "Dunkel Text," the precursor of the final GATT agreement; in November 1993 immediately preceding the final round of the negotiations in Geneva in December 1993; and in February 1994 following agreement to the Final Act in which the new WTO was created. IIPA also actively worked with this Subcommittee and with the Judiciary Committees in both the House and Senate on the Uruguay Round Agreements Act ("URAA") which was adopted in December 1994. The new World Trade Organization came into being on January 1, 1995 and pursuant to the Final Act and the URAA, the TRIPS agreement entered into force for the U.S. on January 1, 1996.

In this statement, IIPA would like to review some of the key milestones in the history of the TRIPS agreement, outline the critical importance to the copyright-based industries of its proper and full implementation by our trading partners, and some of the next steps to be taken by our industries, by the Administration and by the Congress to ensure that the TRIPS agreement reaches its full potential for safeguarding the future for trade in intellectual property-based products in the 21st Century.

The IIPA is a coalition of eight trade associations that collectively represent the U.S. copyright-based industries -- the motion picture, music and recording, business and entertainment software and book publishing industries. IIPA's member associations are:

American Film Marketing Association (AFMA);
Association of American Publishers (AAP);
Business Software Alliance (BSA);
Information Technology Industry Council (ITI);
Interactive Digital Software Association (IDSA);

-Motion Picture Association of America (MPAA);
National Music Publishers' Association (NMPA); and
Recording Industry Association of America (RIAA).

These industries represent the leading edge of the world's high technology, entertainment and publishing industries and are among the fastest growing and largest segments of our economy.[1]

The Importance of Early and Full Implementation of the TRIPS Agreement

While from the standpoint of the copyright industries, the TRIPS agreement remains flawed,[2] it nevertheless contains critical substantive protections for copyright owners and specific obligations in the all-important area of enforcement. Through the aggressive use of Special 301, other U.S. trade laws and programs, as well as the worldwide attention that has been focussed on the importance of strong IPR protection during the Uruguay Round negotiations, successive Republican and Democratic Administrations have successfully encouraged a great majority of our trading partners to modify their existing copyright laws to bring them up to TRIPS standards. With certain exceptions noted below, our developed country trading partners, for which the TRIPS agreement is now a binding international obligation as of January 1, 1996, have made these necessary changes in their substantive copyright laws. Even many countries that, rightly or wrongly, classify themselves as "developing" countries and that will seek to take advantage of the additional four-year

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[1]In a report released on February 16, 1995 entitled "Copyright Industries in the U.S. Economy: 1977-1993" which was prepared for the IIPA by Economists Incorporated, we outlined the importance of these industries to the U.S. economy. For example,

- The core copyright industries accounted for $238.6 billion in value added to the U.S. economy, or approximately 3.74% of the U.S. Gross Domestic Product (GDP) and the total copyright industries accounted for $362.5 billion in value added, or approximately 5.69% of GDP (in real 1993 dollars).
- The core copyright industries enjoyed more than twice the growth rate of the economy as a whole between 1991 and 1993 (5.6% vs. 2.7%).
- Employment in the core copyright industries grew at close to four times the employment growth in the economy as a whole between 1988 and 1993 (2.6% vs. 0.7%).
- Between 1977 and 1993, employment in the core copyright industries doubled to 3 million workers, about 2.5% of total U.S. employment. Over 5.7 million workers were employed by the total copyright industries, about 4.8% of the U.S. work force, in 1993.
- The core copyright industries contributed at least an estimated $45.8 billion in foreign sales to the U.S. economy in 1993, approximately an 11.7% gain over the $41.0 billion contributed in 1992. The copyright industries are second only to motor vehicles and automotive parts among U.S. industries in terms of estimated foreign sales and exports.

[2] In previous testimony before this subcommittee, IIPA outlined the shortcomings of the agreement, in particular, its failure to provide full national treatment to U.S. rightholders and its overly long transition periods for developing countries. There were also omissions in the substantive level of protection, including the failure to allow the rightholder to control parallel imports, the failure to define the term "public" in connection with exclusive rights that are ties to public distribution or communication of a work or sound recording, and the overbroad scope of exceptions to protection permitted countries with respect to sound recordings.

-"transition" period permitted under Article 65 have, or will shortly, amend their substantive laws to bring them into compliance with the substantive portion of the TRIPS copyright text (Articles 9-14). This record is not nearly as good with respect to bringing enforcement systems up to the standards demanded in the enforcement text.

IIPA estimates that losses due to piracy worldwide in 1995 amounted to $18 billion to $20 billion. While some of these losses can be attributed to the inadequacy of substantive laws in countries, most are due to enforcement failures that, if the enforcement text obligations were implemented promptly and strictly, could result in significant revenue and job gains to the U.S. economy. Many of these enforcement deficiencies occur in developed countries that are now in violation of their enforcement obligations under the TRIPS agreement.

Furthermore, many of the countries where loss levels are the highest are expected to take advantage of the four-year transition period, unless efforts are made by the U.S. to encourage them not to do so. In our 1994 testimony before this Subcommittee, IIPA noted that countries like Turkey, Egypt, South Korea, Indonesia, Brazil, Thailand, Venezuela, Philippines, India and Poland, which are all now WTO members, accounted for up to $1.8 billion in losses due to copyright piracy in 1993. For 1994, these losses have escalated to an estimated $1.97 billion. Therefore, if these countries take advantage of the full transition period, (and assuming losses remain the same for each year), these industries and the U.S. economy would lose an estimated $8 billion just over this period. The losses to the U.S. economy if all "developing" countries that are WTO members delay improvements (up to TRIPS standards) in enforcement for the full four years of permitted transition would be many multiples of this figure.

It is clearly in the U.S. interest to obtain prompt and full compliance with the TRIPS agreement. Congress has provided many, but not all in our view, of the tools needed to encourage compliance. The Administration must implement these tools, and use the existing consultation and dispute settlement mechanism aggressively if the full TRIPS benefits are to be realized.

The Uruguay Round Agreements Act (URAA)

When it adopted the URAA, Congress provided a number of tools to the Administration that will be helpful in leveraging prompt and full TRIPS compliance:

- It set forth a new set of negotiating objectives which required the Administration (a) to work to accelerate TRIPS compliance by developing countries, and (b) to seek protection in foreign countries that supplements and strengthens TRIPS standards, particularly in light of the rapid growth of technology and, in the case of the copyright industries, the challenges posed by advanced digital networks.

- It strengthened and urged continuing emphasis on Special 301 which has done more than any other provision of U.S. trade law to improve the level of worldwide protection for U.S. products embodying protected copyrights. The URAA made clear that "adequate and effective" protection -- the standard now pertaining in Special 301 that countries must meet -- is not met merely by a country adhering to the TRIPS agreement. It also gave the President authority to retaliate in areas beyond those just related to trade. This would include denying non-trade-related benefits, such as foreign aid or other financial benefits, to offending countries. It asked the USTR to take into account the history of a country's appearance on Special 301 lists, and its

response to negotiations, in deciding whether to designate a country as a Priority Foreign Country. It allowed the President to take away all unilateral trade benefits provided under programs like the Generalized System of Preferences (GSP), Caribbean Basin Initiative (CBI) and the Andean Trade Preferences Act (ATPA) even where those benefits exceeded the actual losses suffered within the U.S. economy. It made clear that non-discrimination --by way of national treatment and in the area of market access -- is an essential corollary to adequate and effective protection. This assures that U.S. rightholders can market their products free of discrimination and reap the full commercial benefits from their property, in addition to having it protected against piracy. Finally, it incorporated into Section 301 the WTO dispute settlement timetables to encompass actions brought under Special 301 which allege violation of WTO obligations. It left intact the six month timetable for disputes under Special 301 which do not allege a violation of TRIPS.

- It renewed, albeit for a short period which has now expired, the GSP Program, which has given the U.S. considerable leverage against developing countries without violating the WTO. It also made the same change in the adequate and effective standard that was made in Special 301.

- It required that USTR report annually to the Ways and Means Committee and the Senate Finance Committee improvements in IP protection and market access for IP-based companies.

These bilateral trade tools -- Special 301 and the GSP Program -- have proved essential in improving protection for U.S. intellectual property rights and, as modified by the Congress in the URAA, must continue to be aggressively used to accelerate the adherence by developing countries to their full TRIPS obligations before the end of the transition period. In this regard, we urge that the GSP Program be renewed as soon as possible.

The URAA also made changes in U.S. law governing intellectual property rights to conform our law to the requirements of TRIPS. In the copyright area, the URAA:

- made permanent the exclusive right of the rightholder in a computer program to control its commercial rental;

- made illegal and subject to criminal penalties the unauthorized fixation in a sound recording or music video of a performer's performance and the trafficking in such fixations;

- restored into copyright protection foreign works which fell into the public domain for failure to follow U.S. formalities or for lack of national eligibility. This change was made to implement Articles 9 and 14.6 of TRIPS and has already set a critical precedent with our trading partners (see the discussion of Japan below) encouraging them to restore protection to U.S. copyrights in their countries -- bringing hundreds of million of dollars of new revenue to U.S. rightholders that own older copyrights.

TRIPS Implementation Activities and Strategies

TRIPS Council

Under TRIPS, the monitoring of the operation of the agreement and its implementation by WTO members is given over to the Council for Trade-Related Aspects

of Intellectual Property Rights (known as the TRIPS Council). Essentially a Committee of the Whole, consisting of all the current 119 WTO members (as of February 22, 1996), the TRIPS Council has met a number of times since January 1, 1995, inter alia to develop rules and procedures for the notification by WTO members of substantive and enforcement-related laws and regulations under the transparency provision of Article 63. Such laws and regulations are currently in the process of being notified and this process should prove helpful in identifying problem areas. Developing countries insist that these notification rules are only applicable at this point to developed countries or any other country that decides to be bound at this time to its full TRIPS obligations. These countries should be encouraged to notify immediately.

The TRIPS Council has also established a schedule for reviewing implementation of TRIPS obligations by developed countries and by all countries, even if developing, least developed, or "in transition to a market economy," with respect to their obligation under Articles 65 and 66 to provide national treatment and Most Favored Nation (MFN) treatment as of January 1, 1996 (even if all other obligations under TRIPS do not become effective in any country until after passage of the transition period). During the week of July 22-26, 1996, the TRIPS Council will review implementation of members' copyright obligations. This involves each member state responding to questions put to it by other TRIPS Council members on the status of that member's implementation of the copyright text. USTR is planning to prepare such questions for submission to other members by the Council's deadline of April 30, 1996.

IIPA views this as an important means to put pressure on countries that have not fully implemented their obligations to do so immediately or risk the commencement of a formal consultation and dispute settlement process. While the TRIPS Council has not scheduled a session on compliance with the enforcement text until 1997, it is hoped that USTR will put questions in this area as well to members with copyright enforcement deficiencies for discussion during the week of July 22.

IIPA Activities

In its February 20, 1996 submission to USTR under the Special 301 provisions of U.S. trade law, IIPA highlighted various TRIPS substantive and enforcement deficiencies in a number of countries. These deficiencies were placed in a new category of "priority practices" for purposes of possible review under Special 301 and included:

- the failure to accord an exclusive rental right in computer programs and/or sound recordings under Articles 11 and 14.4. Countries highlighted included Singapore, Luxembourg, Hong Kong and Israel. Other countries include Argentina, Indonesia, Pakistan, Paraguay and the Philippines. Non-WTO member countries include Bulgaria and possibly Vietnam whose legislation is unclear.

- the failure to provide retroactive protection back a full 50 years (or life of the author plus 50 years) under Article 9 and 14.6 of TRIPS for existing works and sound recordings where it has not fallen into the public domain in the country of origin through expiration of the term of protection. Countries highlighted included Japan (see discussion below), South Korea, Turkey and Kuwait. Other key countries which do not provide such protection include certain non-WTO members like Russia, Ukraine, Taiwan, and Saudi Arabia.

- the failure to provide national treatment under Articles 65 and 66. This refers to countries which may argue that they qualify for availing themselves of the transition

- period but fail to give copyright protection to U.S. sound recordings (as an example) while giving protection to sound recordings of domestic origin. Countries highlighted included Poland and Bolivia.

- the failure to provide national treatment under Articles 3 and 4 to U.S. rightholder's for the "producer's" share in video and audio levy systems. France and Belgium were highlighted.

Additionally, IIPA outlined enforcement deficiencies including:

- the failure to provide deterrent criminal remedies and penalties. IIPA highlighted Italy and Greece in this category as well as Turkey, Mexico, Indonesia, Thailand and others. Non-WTO members include China and Russia.

- the failure to provide provisional remedies under Article 50, particularly the failure to provide for ex parte search authority in civil cases -- a critical remedy for the computer software industry. Countries highlighted included Germany, Sweden, Japan and South Korea.

In preparation for the July 1996 TRIPS Council meeting, IIPA is now in the process of preparing reports evaluating TRIPS copyright and enforcement implementation in thirty countries for submission to USTR prior to its April 30 deadline. Later this year, this project will be extended to report on an additional 20 countries, for a total of 50 countries that are the U.S.'s most important trading partners in the copyright area.

First TRIPS Dispute Settlement Proceeding Against Japan

IIPA applauds Ambassador Kantor for commencing the first TRIPS dispute settlement proceeding on February 9 against Japan for its failure to protect U.S. sound recordings created between 1946 and 1971. The first formal consultation between the two governments took place on March 4 in Geneva, Switzerland. Japan informed the U.S. that it would change its law but did not provide details of substance or timing sufficient to terminate the case. IIPA presumes that the result will be positive and set a useful precedent for other countries, including those highlighted above, bringing their law into compliance with this obligation. RIAA estimates that more than 12 million unauthorized recordings of pre-1971 performances are sold annually including of performances of some of the U.S.' most vibrant and popular artists, such as Elvis Presley, Chuck Berry, Johnny Cash, Bob Dylan, Duke Ellington, John Coltrane and many others.[3]

"Accelerating" TRIPS Adherence: Use of Bilateral Trade Tools

Because of the lengthy transition periods permitted under TRIPS, Congress recognized the critical importance of preserving existing bilateral trade tools to hasten adherence to the agreement's obligations. Among the most important tools are the existing preferential trade programs, such as GSP, CBI and the ATPA, which extend duty free trade treatment to countries which may seek to take advantage of these transition periods. It was envisioned that many of these countries which continue to condone high levels of piracy, and which fail to make needed improvements, would put their benefits at risk under these programs. The GSP program has been particularly useful in leveraging improvements and

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[3] We also commend Ambassador Kantor for commencing another WTO dispute settlement proceeding against Canada involving the eviction of Sports Illustrated Canada by the Canadian government. This decision was announced last Monday, March 11.

the threat of termination of benefits was particularly helpful in countries like Indonesia, Singapore, Cyprus, Thailand and others. We urge Congress to restore this program. Because of the extended coverage of TRIPS in the area of IP protection and enforcement, GSP is a key point of leverage whose "sanction" (e.g. removal or limitation of benefits) remains permissible under the WTO.

Similarly, the CBI and ATPA programs serve the same useful function. However, we strongly encourage the Congress to strengthen both these programs by making certain amendments which would protect IP-based industries. An amendment which would parallel that already made in the GSP Program -- ensuring that mere compliance with TRIPS would not necessarily meet the U.S. IP standard for all these programs that "adequate and effective" protection be provided -- should be made for both CBI and ATPA. Both programs should permit the private sector to petition USTR to withdraw, suspend or limit benefits for failure to provide "adequate and effective" protection, and this authority should be expressly clarified in both programs.

The U.S. has a number of ongoing trade initiatives which could be helpful in accelerating TRIPS compliance and in further lifting levels of protection and enforcement. Both the APEC and FTAA ministers have placed IP issues on their free trade agendas. APEC declarations expressly cover prompt implementation of TRIPS and it is hoped that FTAA will also. But central to the success of these programs, as far as copyright industries are concerned, is the ability to offer additional and immediate trade liberalization to these countries in return for early TRIPS compliance. To date, it is our understanding that the U.S. does not have sufficient authority from the Congress to enter into such discussions at this time and IIPA urges that consideration be given to strengthening the Executive Branch's hand in these negotiations.

The accession of Chile to NAFTA not only would encourage early TRIPS adherence by other countries in the region but lift the level of protection up, at a minimum, to the higher standards provided in the NAFTA. IIPA urges the Administration and the Congress to work together to fashion fast track legislation that would get these negotiations moving again.

Strengthening the TRIPS Agreement

The first meeting of WTO Ministers is scheduled for Singapore in December of this year. Efforts should begin then to improve TRIPS standards of protection and enforcement.

A key initiative in the U.S. to lift standards of protection for copyright owners was the introduction of H.R. 2441 and S. 1284, the National Information Infrastructure Copyright Protection Act of 1995. This all-important legislation would clarify a number of areas of copyright protection to ensure that the U.S. Copyright Act provides effective protection with respect to transmissions of protected works over advanced networks like the Internet. It would outlaw devices and services intended to break encryption or circumvent other technologies that copyright owners choose to employ to protect copyrighted materials from unauthorized copying or transmission. It would also forbid tampering with or falsifying digital tags and other information identifying the ownership of copyrighted materials. IIPA supports the thrust of this legislation designed as a "digital update" to existing law.

At the same time that this legislative initiative is proceeding in the U.S., an exercise in the World Intellectual Property Organization (WIPO) to craft a Protocol to the Berne Convention and a "New Instrument" or new treaty to govern the protection of sound recordings is nearing completion, with a Diplomatic Conference now scheduled for December 1996. This international effort would, similar to pending U.S. legislation, adapt

-the international copyright rules to the reality of the digital world. The U.S. is making many of the same proposals in WIPO that are contained in the pending bills referred to above.

If this effort in WIPO is successful, the Singapore Ministerial should take cognizance of the need to incorporate the new WIPO rules as soon as possible into TRIPS. If the WIPO result is acceptable to the U.S., it will significantly enhance the effort to build a Global Information Infrastructure for the 21st century. U.S. content providers -- namely, the U.S. copyright-based industries -- will benefit enormously from this effort both in terms of revenue and job growth. Critical however will be the ability to use the leverage of TRIPS, as well as existing U.S. bilateral tools, to ensure that all countries have implemented these higher levels of protection and are prepared to enforce those rights.

Services

IIPA, whose member associations are large providers of internationally traded services -- publishing, business software services, audiovisual services, and other entertainment services, is also concerned with the effective implementation of the Services Agreement (GATS).

While many countries made commitments to ensure market access and national treatment on computer services, it is widely known that the filmed entertainment industry fared particularly poorly in the GATS negotiations. Only fourteen countries[4] made commitments with regard to filmed entertainment.

Although other industry sectors represented by IIPA, especially those representing computer software interested, fared better in terms of numbers of commitments, there are serious problems in understanding and enforcing those commitments. Even where commitments were made, the existing classification system for services is so rudimentary that its lack of clarity and precision inhibits enforcement of existing commitments. It is essential that work begin immediately to make the services commitments more widely available in a format useful to business users.

The GATS calls for a new round of market access negotiations to begin in the year 2000. It is critical for the United States Government to begin preparations immediately for this upcoming round of services market access negotiations. These efforts should particularly focus on means of facilitating progress in obtaining commitments in audiovisual services, and in services affected by the rapid changes in technology and the convergence between many information and entertainment services.

Furthermore, some very large and growing services sectors are not even included in the current classification list. As technologies change and businesses converge, the inadequacies of the current classification system will only become worse. For example, cable transmission services and satellite transmission services, except to the extent that these services transmit voice telephony services, are not included in the GATS list of services. The existing classification system has no reference to multimedia services.

While the Services Agreement in theory encompasses all commercially traded services currently available or to be developed in the future, in practice, few countries are willing to make commitments in sectors not included in the services classification list.

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[4] Dominican Republic, Hong Kong, India, Israel, Japan, Kenya, Korea, Malaysia, Mexico, New Zealand, Nicaragua, Singapore, Thailand, and the United States.

Improvements in the classification list will be necessary to facilitate negotiation of commitments, especially in sectors missing from the current classification list.

Conclusion

Full and prompt implementation of the TRIPS agreement, in addition to use of all bilateral trade tools available, is a key objective of copyright-based industries in the IIPA. Effective implementation, clarification and expansion of the Services Agreement is also critical to ensure that America's copyright-based industries secure the guarantees of market access and national treatment available to other services industries. We appreciate this Subcommittee's attention to these important issues and look forward to working with the Chairman and members in 1996 and beyond.

Thank you.

Chairman CRANE. Thank you, Mr. Smith.
Mr. Vastine.

STATEMENT OF J. ROBERT VASTINE, PRESIDENT, COALITION OF SERVICE INDUSTRIES

Mr. VASTINE. Thank you, Mr. Chairman, for again affording the Coalition of Service Industries an opportunity to express its views. The service sector is committed to opening foreign markets for our exports because exports stimulate economic growth and American jobs.

Yesterday, the Commerce Department released data showing a record surplus on service sector trade of $63.1 billion for 1995. Overall, services exports grew to $280.8 billion. These exports are the outward expression of the world's most highly competitive service economy that accounts now for about 65 percent of U.S. economic activity and nearly 80 percent of total U.S. employment. Over the past year, 1.49 million net new jobs, according to the Labor Department, were created in the United States, all of them in services and many of them well paid.

We have put enormous effort into opening services markets through the Uruguay Round and the WTO. But the main achievement of the Uruguay Round in services, the General Agreement on Trade and Services, or the GATS, did not yield significant trade liberalization in a number of important service industries. Thus, after the close of the Uruguay Round, negotiations began again under the WTO in financial services, telecommunications, maritime services, professional services, and the movement of professional personnel.

The ability ultimately to produce good agreements in these and other service sectors will be a crucial test of the WTO's effectiveness. With regard to the financial services negotiations which concluded last July 1, the offers of a significant number of countries failed to provide new market access and national treatment to our firms. Indeed, some countries' offers did not protect current levels of access, raising the possibility they might force the divestiture of existing U.S. investments in certain countries.

As a result, at the close of the negotiations last year the United States and 15 other WTO members exercised their international legal right under the GATS to take an MFN exemption for financial services. The interim WTO Agreement on financial services that concluded last July provides for another round of negotiations to be completed by December 31, 1997. In essence, the WTO parties have decided to give this effort a third try. We expect other WTO members and our private sector counterparts in other countries will be equally committed to a positive result. If they are not, the negotiations will again fail.

We believe the United States should now use other bilateral and regional forums such as APEC, the Transatlantic Dialog, and the OECD investment agreement negotiations to work collaterally toward the ultimate goal of liberalization and to reinforce the effort being made in the WTO. If the next round of WTO negotiations is not successful in financial services, the United States will be forced to seek its market access goals through bilateral or regional trade arrangements.

As in the case of financial services, the telecom negotiations were not concluded when the Round ended in 1993 and negotiations continue with a termination date of April 30 of this year. Users of telecom services throughout the world are burdened by an enormously inefficient, asymmetrical telecommunications market dominated in most countries by entrenched, politically powerful State monopolies.

As the most efficient worldwide provider of telecom services, the United States has a major stake in correcting the gross inequities of this market. It is estimated that the United States has a $3.8 billion trade deficit in telecommunications because of practices in the so-called international accounting rate system that discriminate against the United States. If the negotiations do not meet the test of greater access and efficiency of markets and fail, one option would be to raise this issue to the level of trade ministers and to give it a prominent place on the agenda at the WTO Ministerial Meeting in Singapore next December.

With regard to professional services, many professional firms, especially accounting firms, considered the Uruguay Round a success. In accountancy, roughly 90 percent of the world market was covered in the final schedule of commitments.

Professional services continue to be an important goal, an important subject for work under the WTO, which has a working party on professional services. The goal there in accountancy is to promote international accounting standards, facilitation of mutual recognition agreements for professional certification, and disciplines against the misuse of regulation as a barrier to trade and investment. Our goal is to urge completion of the work in this important working party by the end of 1997.

Finally, in the movement of professional and technical personnel, which is a very important issue for a large number of U.S. service providers who need to shift highly qualified professional and technical people around the world at an instant's notice, the problems of obtaining business visas in a number of countries are very, very great. The efforts in the WTO to try to reach an agreement in this area were left off essentially last June without success.

In conclusion, in the immediate post-Uruguay Round period, the WTO has had a difficult mission. It must oversee the implementation of the many complex agreements made in the Round, initiate the new dispute resolution process, and conclude negotiations in a number of important service sectors. The record, of course, is mixed. The WTO Ministerial scheduled for December will provide a welcome opportunity to review both progress and problems, and to inject a new sense of mission and of politic urgency into negotiations in several key service sectors.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF J. ROBERT VASTINE
PRESIDENT, COALITION OF SERVICE INDUSTRIES

Mr. Chairman, members of the subcommittee, thank you for holding today's hearing on the services sector work of the WTO, and for again affording the Coalition of Service Industries an opportunity to express our views.

From its founding 14 years ago, CSI has been the leading advocate worldwide of a comprehensive global trading regime for services. We committed ourselves to using the Uruguay Round to the fullest to achieve this objective. We remain committed to the WTO as the most important global forum through which to obtain meaningful liberalization of trade in services.

I believe it is useful to review the reasons why we as service companies are so committed to achieving more open foreign markets for our exports, and why this goal is so clearly in the nation's interest.

The reason is economic growth and American jobs. Yesterday the Commerce Department released data showing a record *surplus* on service sector trade of $63.1 billion. Overall services exports grew to $208.8 billion. These exports are the outward expression of the world's most highly competitive, dynamic service economy that accounts now for about 65 percent of US economic activity, and nearly 80 percent of total US employment.

Over the past year, 1.49 million net new jobs were created in the US, all of them in services.

These are not "hamburger flipper" jobs. Among the biggest job gains were 110,000 in business services like computer and data processing, where average wages rose to $17.98 an hour; 284,000 in health care, where the average wage rose to $12.66; 158,000 in engineering and management services, where wages rose to $15.99; and 70,000 in finance, insurance and real estate, where wages rose to $12.55. The perception, common on Capitol Hill and on the campaign trail that the high paid American jobs are being destroyed by imports, only to be replaced by low-wage service jobs, would appear to be a myth.

In your hearing announcement, Mr. Chairman, you stated that the Subcommittee's purpose today is to examine the implementation of the Uruguay Round and the WTO, the progress made thus far, and prospects for the future.

The main achievement of the Uruguay Round in services was of course the General Agreement on Trade in Services (GATS). The GATS was certainly an important milestone, in that it contains a set of rules and disciplines and an institutional framework that, together, give services the same stature as goods in the world trading system.

A major disappointment, however, was that the GATS did not yield significant trade liberalization in a number of industries that comprise a very significant portion of the services sector. Thus it was understood, at the end of the Round, that much hard bargaining had to be done to achieve concrete progress. Negotiations were then begun under the WTO's auspices, in major sectors including financial services, telecommunications, maritime services, professional services, and movement of professional personnel. The ability to produce good agreements in these and other service sectors will of course be a crucial test of the WTO's effectiveness as the guardian of the multilateral world trading system that has been so carefully constructed in the post World War II era.

Financial Services Negotiations

In the financial services negotiations, where the CSI's Financial Services Group played an active role, the United States' overriding goal through nine years of effort was to secure real market access and full national treatment for US financial service providers. We sought commitments from our trading partners to open their markets on a predictable schedule.

Unfortunately, the offers of a significant number of countries with commercially important and growing financial markets fell short because they failed to offer new market access and national treatment to our firms. Indeed, some countries offers did not even protect current levels of access, raising the possibility that they might force the divestiture of existing US investments.

As a result, at the close of the negotiations on July 1, last year the US and 15 other WTO members exercised international legal right under the GATS to take an MFN exemption for financial services. *That is, the US decided that it was in its best interest not to legally commit, or bind itself to permit all foreign firms to establish new, or expand existing financial services operations in this country.*

The US did agree, however, to protect existing foreign investments in financial services in the US, *a commitment a number of WTO members refused to make.*

The Interim WTO Agreement on Financial Services concluded last July provides for another round of negotiations, to be completed by December 31, 1997. In essence the WTO parties have decided to give this effort a third try. As a full member of the GATS the US has legal rights with respect to all the financial services commitments of all other WTO members, including those made under the Interim Agreement. We support a third round of negotiations to secure a true liberalization of global financial markets.

The CSI is committed to work with our government and our trading partners to achieve a successful WTO financial services agreement. We expect, however, that other WTO members and our private sector counterparts in other countries are equally committed to a positive result. If they are not, of course, the negotiations will fail for a third time.

We believe that freeing global financial markets will be good for everyone. For our companies, as the world's most sophisticated providers of these services, the payoff is obvious. For developing countries, particularly in Asia and the Pacific where restrictions on foreign participation are the rule, the payoff is greater prosperity.

If in the coming WTO negotiations other countries are unwilling to make commitments that produce real liberalization, the US will be forced to seek its market access goals through other trade arrangements on a bilateral or regional basis.

Telecommunications

Telecommunications has been a major subject of negotiations in the Uruguay Round since its outset. As in the case of financial services, the telecom negotiations were not concluded when the Round ended in 1993, and negotiations continued with a termination date of April 30, this year.

The US has taken a lead role in the negotiations, and has tabled a very generous offer for the consideration of other parties. If reciprocated by them, the negotiations will result in an open, competitive worldwide telecommunications marketplace, a very exciting prospect indeed.

It may be useful to frame the negotiations in terms of the enormous financial stakes at play here.

Users of telecom services, throughout the world, are burdened by an enormously inefficient, asymmetrical telecommunications market, dominated in most countries by entrenched, politically powerful state monopolies.

As the most efficient worldwide provider of services, the US has a major stake in creating a more efficient marketplace. It is estimated that the US has a $3.8 billion trade deficit in telecommunications because of practices in the so-called international accounting rate system that discriminate against the US.

Will these negotiations be successful at the end of the last day in April? The offers of other countries currently are not considered satisfactory. The US must judge the agreement on whether it will reduce costs for US telecom users, provide new access for US telecom providers, and in general create more efficient, equitable markets.

If the negotiations do not meet these tests, what is the US strategy to advance the critically important objective of more open, more efficient telecom markets? One option would be to raise this issue to the level of Trade Ministers, and to give it a prominent place on the agenda at the WTO Ministerial Meeting in Singapore next December.

Maritime Services

As in telecommunications, the maritime services negotiations are now in progress, with a terminal date of June 30. The US has elected not to make an offer, because our negotiators believe the offers of other WTO parties are insufficient.

Professional Services

Many professional services firms consider the Uruguay Round a success. In accountancy, for example, roughly 90% of the world market was covered in the final schedule of commitments. While many of these commitments were standstill agreements, or guarantees of the status quo, they can often be of great commercial value.

Professional services negotiations continue under the WTO's Working Party on Professional Services, which began by focusing on accountancy but will later take up engineering and consulting services. The Working Party's goals are ambitious and very important to US accounting firms, which have a worldwide competitive edge. They are: promotion of international accounting standards; facilitation of mutual recognition agreements for professional certification; and disciplines against the misuse of regulation as a barrier to trade and investment.

The CSI is calling on the US government and other participants in the Working Party to make significant progress on this agenda by the Singapore Ministerial in December. Our goal is completion of this work by December, 1997. The Coalition has just established a Professional Services Working Group to monitor progress and support the efforts of governments toward liberalization.

Movement of Professional and Technical Personnel

Free movement of professional and technical personnel is essential because it is one of the key ways in which services are provided, or traded. And it is increasingly important to US services firms who, in order to serve clients throughout the world, must have the ability to send professionals, and technical experts abroad on a moment's notice. A recent study by the Pacific Economic Cooperation Council shows that every one of the 16 developing countries of the Asia Pacific Economic Cooperation (APEC) maintains restrictions on the entry of foreign business travelers.

Here again negotiations, begun in the Uruguay Round, were continued afterward under the WTO. They concluded with a murmur late in June, 1995, and there is currently no effort to pursue them in the WTO context.

What is needed is an international understanding about business travel, and about the taxation of the personal income of business travelers. The CSI has convened a working group of its members to formulate recommendations for a code of international practice covering business visas, temporary work permits, and taxation.

Conclusion

In the immediate post-Uruguay Round period the WTO has a difficult mission. It must oversee the implementation of the many complex agreements made in the Round, initiate the new dispute resolution process, and conclude negotiations in a number of important service sectors. The record, so far, is mixed. The WTO Singapore Ministerial scheduled for December will provide a welcome opportunity to review both progress and problems, and to inject a new sense of mission into negotiations in several key sectors.

Chairman CRANE. Thank you, Mr. Vastine.

Mr. Houghton.

Mr. HOUGHTON. Thank you very much for testifying today. I would like to ask a couple of questions. One is really for information. I do not understand the problem with the TRIPs issue. This is for my own information.

TRIPs was established in order to help the U.S. economy and help emerging economies. Now the question is trying to condense that 4-year period. What is the problem? Why do we want to do that?

Mr. SMITH. Congressman, I think the reason we want to do this is that if these countries continue to not have their laws and practices in compliance with this higher level of protection provided in the WTO TRIPs Agreement, the U.S. economy loses billions of dollars each of those years that those countries do not——

Mr. HOUGHTON. Yes, but we knew that when it was signed. It was a concept established at the Uruguay Round 10 years ago and we knew that—we did not know the financial implications, but we knew it was the right thing to do. So if you were a member of an emerging country and you would establish a trading pattern, how would you feel if the United States said, Hey, wait 1 minute, let's condense this time. Is it fair? Do they know it is unfair? What are the critical issues here?

Mr. SMITH. I think some of them believe it is unfair. Fortunately, many of these countries have already made the decision for internal reasons to advance their compliance, for the very reason they consider it in their own interest to do so. There are some countries who for political reasons within the international community will refuse to do so. It is really those countries I think we are most interested in.

Just to give you an example. South Korea in the area that I am most aware of, in the copyright area, will bring its regime up to TRIPs compliance very, very shortly. In fact, they hope to do so by the end of 1995. The reason for that is they believe it is in their domestic interest to do so. What we are asking for is for USTR, through their normal bilateral channels, to continue to push and persuade these countries to——

Mr. HOUGHTON. Keep that pressure up.

Mr. SMITH. Yes.

Mr. HOUGHTON. Thank you very much. Now I would like to ask Mr. Vastine a question about telecommunications. Obviously, this is a hot topic for us. We have just passed legislation. We hope it is going to create jobs, open investment, all sorts of things like this. Why do you think it would be possible, with past practices which go right to the core of a society, to have open and free telecommunications bidding, and purchasing, and buying on the worldwide market?

Mr. VASTINE. In other words, why do we think it might be possible?

Mr. HOUGHTON. Yes. I think you were saying if we have the proper negotiations and they are properly reciprocated then the negotiations would result in an open, competitive, worldwide telecommunications marketplace. It is a good intellectual idea, and I would like to see that also. I think we all would because there are

tremendous opportunities here. But this has been, particularly with the telephone companies, almost like the postal service, such a highly protected area. And it goes far beyond the law. I mean, it is just sort of endemic to the whole stature of the society.

Mr. VASTINE. Yes, I understand your point, Congressman. After all, it took a long time for us to get where we are now in terms of opening up our own market to real competition. I think ultimately the only way to gain the market access we seek is to convince users in foreign countries that they are being outrageously overcharged for the services they need in order to grow as economies.

One very good way to encourage change in some of the more entrenched countries where the PTTs are so well established is to demonstrate that investors will be very reluctant to invest in a country where they are not able to take advantage of efficient communications or telecommunications services and where those are very expensive. So, hopefully, we will be able to convince other countries simply on the basis of their own domestic, commercial job-creating advantage that it is in their interest finally to let go of some of these——

Mr. HOUGHTON. So the technology is so commanding that with certain economies, certain large economies opening up and the reactions to that in terms of services and products and exchanges and job creation, they are going to be left behind.

Mr. VASTINE. Right. Some people point to Chile as an example of an opening that has taken place and has helped result in much more economic growth. But it is going to be a difficult sell.

I suppose there is another fix. That is, just the extraordinary impact of technology. As Motorola, just for example, has success with Iridium, or other companies have success with their direct uplinking telephonic communications, local telecoms will simply be obsolete and maybe the whole problem will be just sort of leapt over. But I think that is probably in the distant future and really our interest is to expand these markets to the extent we can for traditional telecom services.

[The following was subsequently received:]

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Peter C. Richardson
Senior Assistant General Counsel
General Patent Counsel

March 15, 1996

The Honorable Amo Houghton, Jr.
United States House of Representatives
Washington, D.C. 20515

Dear Representative Houghton:

Unfortunately time did not permit me to respond to the question that you posed to the panel on which I testified about the "fairness" of seeking the accelerated implementation of the transition periods allowed the developing countries (LDCs) under the WTO Intellectual Property (TRIPS) Agreement. The panel was part of the day-long hearing that the Ways & Means Trade Subcommittee held on March 13, 1996 on the implementation of the Uruguay Round agreements. I take this opportunity to provide a written response and ask that this letter be made part of the hearing.

It is unfortunate that the TRIPS Agreement has come to be viewed as a major concession that the LDCs were forced to make during the Uruguay Round negotiations and that, consequently, strong intellectual property is not in their best interest. On the contrary, we believe that LDC adoption of the TRIPS standards of intellectual property protection and enforcement will benefit their economic development.

The historical record in the industrialized countries, which began as developing countries, demonstrates that intellectual property protection has been one of the most powerful instruments for economic development, export growth and the diffusion of new technologies, art and culture. More recently, those countries that have adopted improved intellectual property protection have seen significant increases in foreign investment inflows and the transfer of vital technology. At the same time, intellectual property protection has stimulated local innovation and creativity as the potential rewards motivate local innovators and creators to take risks that are associated with the adaptation of foreign technology to local needs. It is only after -- not before -- the adoption of strong intellectual property protection that the necessary incentives will be in place for this risk-taking. I have enclosed a short paper prepared by the Intellectual Property Committee (IPC), on whose behalf I had testified before the Subcommittee, and representatives of European (UNICE) and Japanese (Keidanren) industry which describes the benefits the LDCs can expect from strong intellectual property protection.

The IPC's concerns about the long transition periods contained in TRIPS stem from a number of factors more directly related to the commercial benefits that U.S. industry had expected to receive from the negotiation of an intellectual property agreement in the GATT (now WTO). First, the long transition periods mean that the generally adequate and effective standards of intellectual property protection contained in the TRIPS Agreement will be of little immediate help to U.S. industry, which must wait four to ten years before we can begin to reap any benefits in the LDCs from TRIPS. Newly industrializing countries, such as Argentina and Brazil, which already compete very effectively with the United States and other developed countries across a broad range of technologically-advanced products, will not have to provide TRIPS-level protection until at least January 1, 2000, and in the case of pharmaceutical and agrochemical products, until January, 2005.

Furthermore, while U.S. industry recognized that transition periods would be included in TRIPS, it did not have any reason to expect that they would be so excessively long. In contrast to the transition periods contained in bilateral intellectual property agreements that the United States had already negotiated (e.g. Korea, China) and in NAFTA, which were measured in months or one year, the TRIPS transition periods ranged from five to eleven years. At the time of the negotiations, the U.S. industry made known its strong misgivings about the long transition periods, which were not at all consonant with U.S. practice. In fact, the IPC linked its support of the TRIPS Agreement to congressional passage of the intellectual property provisions of the Uruguay Round implementing legislation, which declared U.S. policy to be the acceleration and improvement of TRIPS standards.

Finally, a number of the more advanced LDCs have already made commitments to the United States, independent of TRIPS, that they would enact high levels of intellectual property protection. Some of these commitments even preceded the conclusion of the TRIPS negotiations. As I noted in my testimony, Argentine Government officials, including President Menem, had repeatedly made commitments to the United States to enact strong intellectual property protection in order to conclude Special 301 investigations. We are still awaiting the implementation of those commitments. In fact, the U.S. Patent and Trademark Office believes that the intellectual property situation in Argentina is actually worsening.

In conclusion, we believe that the proper and accelerated implementation of the TRIPS Agreement is in the interest of both the LDCs and the United States. It is for that reason that we expressed our concerns to the Subcommittee about the TRIPS transition provisions.

Yours truly,

Peter C. Richardson

Peter C. Richardson

Strong Intellectual Property Protection
Benefits the Developing Countries

Intellectual Property Committee (U.S.A.)
Keidanren (Japan)
UNICE (Europe)
April 19, 1988

Intellectual property protection provides incentives for the adaptation of imported products and technology to local conditions and the development of domestic innovation, technology and culture. It furthers economic growth and leads to greater technological self-reliance, thereby making a country less dependent on the technology and creativity of other countries. The historical record in the industrialized countries, which began as developing countries, demonstrates that intellectual property protection has been one of the most powerful instruments for economic development, export growth and the diffusion of new technologies, art and culture.

Developing countries (LDCs) must compete today not only in their own markets but also in regional, if not global, markets. The development of competitive "world class" products and services will require higher levels of technology. Most industrial technology is produced and owned by the private sector, not governments. Private sector companies decide on the timing and the conditions for the transfer of the products and technology and they must find it in their interest to do so. Domestic companies are often in the best position to be aware of problems needing solutions and where and how valuable improvements can be made. They will not have any incentive to develop technology if they are not assured of an adequate return on their investment.

A nation's economic development policy, should, therefore, encourage the importation and local development of products and technology by providing them with adequate protection. Similarly, a nation's cultural development policy should, through adequate protection, encourage local artists, writers, composers, musicians and filmmakers, by ensuring that they can be properly rewarded and that their works do not have to compete against lower cost and often inferior pirated works. Rather than reducing the scope of intellectual property protection, developing countries should recognize the contributions that adequate intellectual property protection can make to their development and provide such protection to all creators and innovators – domestic as well as foreign.

1. Economic benefits of strong intellectual property protection

Strong intellectual property protection produces long-run economic benefits by:

(a) Stimulating innovation by providing an environment in which innovation is rewarded;

(b) Providing lower cost methods of production and distribution of existing products;

(c) Inviting new, safe and effective products and technology;

(d) Creating and providing new, safer and more effective products, processes and services in, and specifically for, in-country markets through the adaptation and improvement of existing products and technology;

(e) Creating jobs in both the primary industries and in supporting industries throughout the economy;

(f) Creating a higher quality and technically-prepared labor force through the on-the-job training associated with authorized transfers of technology;

(g) Increasing the amount of new capital that can be generated for investment in economic development;

(h) Creating advances which will contribute to the level of technology throughout the world and, in the process, gain revenues from others who would benefit from their use; and

(i) Providing, in the cultural industries, an infrastructure designed to reward creative talent – authors, performers, et. al. – through a system of royalties and local and foreign distribution outlets for their works.

2. Technology and product transfers require a conducive environment.

Developing countries should recognize that mandating the terms on which products and technology will flow into an economy will not guarantee the acquisition of the best products or technology. Valuable products and commercial technology are predominantly in the hands of private sector innovators or creators, who have the ability to determine where and how that technology will be exploited. Strong intellectual property protection, by balancing the benefits that the product and technology will provide society as a whole with the need to provide incentives for continued innovation, serves to induce these innovators to bring their technology to the market place. On the other hand, when faced with a country that provides inadequate intellectual property protection or a government that requires that the products or technology be made available at low cost and with restrictions on their use, the creators and innovators will either take their products and technology elsewhere or only make available products that contain older technology that they can afford to "lose."

3. Free riding and imitation condemn a country to perpetual second-class status.

Economic development is a long and dynamic process which cannot spread and sustain itself without the wide participation of the private sector. It cannot be shortcut by governmental policies that interpose the government in the business decision process; attempt to control the inflow of products and technology; establish formal government R&D systems and programs; and seek free access to products and technologies developed elsewhere.

Rather than looking at the cost of importing products and technology, developing countries should look at their economic benefits. While the "free-rider" approach may provide "short-term" benefits to a few local imitators and to the LDC by lowering its balance of payments costs, it will increase long run costs through continued dependence on external sources of old or outdated technology. Without the environment conducive to private sector commercialization provided by adequate intellectual property protection, formal governmental direction of research can only provide marginal assistance to the development process. On the other hand, strong intellectual property protection, which associates inventive efforts with economic returns, works as an effective tool in stimulating the private sector's interest in inventive activity, thereby leading to the introduction and diffusion of new technologies.

An economic climate characterized by extensive infringement because of inadequate intellectual property protection puts a premium on imitation, which contributes little to technological and cultural advancement or to industrial development. Inadequate protection reduces the willingness and the ability of industry to commit to long-term planning and to develop the next generation of products, processes and services not only for its own country markets but also for the regional and global markets in which the local industry must increasingly compete. The absence of a mechanism to ensure industry a return from any investment of resources on innovation also has a chilling effect on the growth of a technically-trained labor force with the needed skills to adapt and improve existing technology and develop local technology. Without adequate and effective intellectual property protection, the technically-prepared work force either leaves the country ("brain drain") or concentrates its efforts on copying, rather than on innovation. In the cultural industries, the ability of local creative talent to create new works is inhibited by the forced competition with cheap and inferior works produced by pirates, who quickly take over the market and who do not pay royalties to the local creators.

4. Economic development is based on the assimilation and adaption of technology and ultimately local innovation.

Economic development depends on the assimilation of appropriate technology with the formation of a local technological capacity. While in the short term, a LDC that follows such a strategy may be technologically dependent on more advanced countries, in the long term it will be able to use the imported technology to provide a necessary base for greater technological self-reliance.

Japan's modernization and economic restructuring after World War Two was based on this model and not on the "free-ride" approach. Japan passed its first patent law in 1885 and its patent law of 1921 has remained the basis for its patent system up to the present time. As a result, long before World War Two, Japan had recognized rights in technology and rewarded those who made it available to them. It assimilated, modified and adapted imported technology and then moved on to local innovation. According to the Bank of Japan, Japan's income in 1955 from the export of its technology abroad amounted to 1% of what it spent on importing foreign technology, but by 1987 that ratio had increased to 33%. While on the national level Japan is still a net importer of technology, its economic and technological development has not been adversely affected. Furthermore, some segments of industry have become exporters of technology.

A good example is the development of Japan's pharmaceutical industry, which today is highly competitive on a global scale. Its development, however, was retarded by the delay in introducing product protection for pharmaceuticals until 1976. While Japan had, since 1885, protection for processes and methods of use, which in some cases provided protection almost equivalent to a product patent, it was not sufficient to discourage local industry from concentrating and investing its resources on "detour" and imitative processes that were, in many cases, economically inferior to existing processes. The technology trade balance of Japan's pharmaceutical industry, which had been in deficit, rapidly improved with the introduction of product patent protection for chemicals in 1976, and, according to Japan's Management and Coordination Agency, has been in surplus since 1986.

5. Conclusion

LDCs are increasingly recognizing that foreign investment and the transfer of advanced technology, often associated with imported products, are critical elements of a successful economic development strategy. An important element of a country's business climate is the protection of intellectual property – those ideas or works which the investment seeks to exploit. Where intellectual property protection is adequate, the advanced technology that is transferred serves as the basis for further local innovation, greater technological self-reliance and dynamic economic growth. Where the protection is inadequate, advanced technology is not transferred and, even when it is introduced into the economy, it is not on terms that are conducive to long-run economic development.

Mr. HOUGHTON. Thank you very much. Thank you, Mr. Chairman.

Chairman CRANE. Thank you. Let me thank all of our panelists for their participation, and reassure you again your complete statements will be a part of the permanent record.

Now our final panel, John Rigolizzo, president of the New Jersey Farm Bureau on behalf of the American Farm Bureau; Aaron Cross, public policy director, Governmental Programs, IBM, Inc., on behalf of the Information Technology Agreement Coalition; and our former distinguished colleague, Jim Slattery, partner, Wiley, Rein & Fielding, on behalf of the Wheat Gluten Industry.

If you will please take your seats. Before we proceed, however, our colleague, Mr. Zimmer from New Jersey, would like to personally welcome Mr. Rigolizzo.

Mr. ZIMMER. Thank you very much, Mr. Chairman. It is my pleasure to welcome Mr. Rigolizzo to testify before this Subcommittee. There are some of my colleagues who are not aware of what a vital agricultural sector New Jersey has. We are in fact a leading producer of fruits and vegetables, and Mr. Rigolizzo is one of the leading farmers in the State of New Jersey.

As a small farmer myself, much smaller than Mr. Rigolizzo, I want to tell you that agriculture is alive in New Jersey. It is under a great deal of pressure from development and high taxes, and that is why our high value-added crops need the markets all around the world that are provided by international trade agreements. So it is a real honor to have New Jersey's representative from the Farm Bureau speak on behalf of the entire Farm Bureau. So I want to welcome you here this afternoon.

STATEMENT OF JOHN I. RIGOLIZZO, JR., PRESIDENT, NEW JERSEY FARM BUREAU; ON BEHALF OF AMERICAN FARM BUREAU FEDERATION

Mr. RIGOLIZZO. Thank you, sir. It is an honor for me, too. I have a longer version that is submitted to you, and I will give you my short remarks.

Chairman CRANE. Very good. Your longer version will be a part of the permanent record.

Mr. RIGOLIZZO. Thank you. Mr. Chairman, and Members of the Subcommittee, thank you for allowing me to present the American Farm Bureau Federation's views on international trade and trade negotiation. You already know I am John Rigolizzo, president of the New Jersey Farm Bureau. The Garden State, along with all the other States and Puerto Rico, combine to form the America Farm Bureau Federation, representing 4.5 million member families nationwide. America's farmers and ranchers raise virtually every crop imaginable. Research and technological advances have made America the food supermarket of the world. It is easy to see why the Nation's farmers are so interested and dependent on world trade.

The American Farm Bureau was heavily involved in the GATT negotiations and vigorously supported its passage by Congress. Part of any good agreement between so many participants is a provision for monitoring progress as well as smoothing out the invisible bumps on the road to success. The WTO is the means to achieving that success. The WTO needs the support of all Americans if

we wish to maintain the principles of the GATT, and if we believe that free and open trade is the key to economic success for America and the nations of the world.

The Farm Bureau believes that higher living standards throughout the world depend on mutually beneficial trade among all nations. We strongly urge that trade and other economic policies be developed to promote, rather than retard, the growth in world trade. In 1994 U.S. agriculture exports to the world reached $43.5 billion. By the end of 1995, this figure reached $54 billion. If trends continue, we could well exceed $60 billion for 1996. This year, for every $2 in agricultural exports the United States will import 1 dollars' worth of farm commodities. That is a nice surplus for anyone's books.

Despite a solid export picture, there are those who will try to circumvent the GATT Agreement. America must remain firm in its commitment to free and open trade. The WTO must be our first line of defense as we seek to maintain that ever-growing need for fairness and stability in the world market.

But like any good defense, there must be a supporting offense. Those who represent us at the WTO and other ongoing trade negotiations need to be armed with good, hard, scientifically proven facts and figures about our agriculture. They need research and technology to prove unequivocally to the world again and again that U.S. farmers provide the safest, highest quality food products anybody's money can buy. At the same time, our trade representatives must be confident in assuring a consistent supply line.

Four days ago, I returned home after spending 16 days in Southeast Asia, specifically Vietnam and Indonesia. Together they have the world's fourth largest population. Only China, the United States, and India have more people. These nations not only want our food products, they have the money to pay for them. The economics and personal incomes in these nations are growing at an astounding rate. Their people want more variety in their diet as well as other goods and services that come with an ever-expanding economy.

In the case of Indonesia, America has made great strides in providing cotton, corn, wheat, and soybeans. But the competition from places like Canada and Australia is fierce. Oftentimes we can only fill the balance of a purchase order because ultimately price makes the sale. I mention this for two reasons. First, it serves as an example that the provisions of the GATT Agreement should be equal for all who sign on the dotted line. That is the job of the WTO, along with the U.S. Trade office and the USDA.

Second, those representing us in the world marketplace, be they the USDA or the U.S. Trade Representative, need the tools of a good marketing program. They need good, reliable information about the marketplace; namely, from places like the Foreign Ag Service. They need consistent funds such as MPP to continue cooperative team efforts that show developing nations firsthand the economic benefits of buying our products. By meeting the food and fiber needs of such nations as Vietnam and Indonesia, peace and social harmony become the norm, not the exception.

In closing, let me say the American Farm Bureau and its member families stand ready to assist the U.S. Trade Representative and our Secretary of Agriculture whenever, wherever their need may be. Together, we can harvest the benefits of good, sound trade policies. Together, we can keep our Nation's farmers on the farm. And together, we can watch our planet become a better world; something only dreamt about just a few short years ago.

Thank you, sir.

[The prepared statement follows:]

STATEMENT OF
THE AMERICAN FARM BUREAU FEDERATION
TO THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON TRADE
REGARDING
IMPLEMENTATION OF THE URUGUAY ROUND AGREEMENTS
INCLUDING THE ESTABLISHMENT OF THE WORLD TRADE ORGANIZATION (WTO)

Presented by
John I. Rigolizzo, Jr.
President, New Jersey Farm Bureau

March 13, 1996

Mr. Chairman and members of the House Ways and Means Subcommittee on Trade, thank you for allowing me to represent the American Farm Bureau Federation's views on international trade and trade negotiations. The Garden State, along with all the other states and Puerto Rico combine to form the American Farm Bureau Federation, representing over 4.5 million member families nationwide. American farmers and ranchers raise virtually every crop imaginable. On-going research and technological advances have made America the "supermarket" of the world. It is easy to see why the nation's farmers are so interested and dependent on world trade. This testimony will concentrate on the most recent General Agreement on Tariff and Trade (GATT) accord from the Uruguay Round and the creation of the World Trade Organization (WTO).

The American Farm Bureau was heavily involved in the GATT negotiations and vigorously supported passage by the Congress. Part of any good agreement between so many participants is a provision for monitoring progress as well as smoothing out the "bumps" on the road to success. The WTO is the means to achieving that success.

The WTO is the principal international forum governing world trade and is the major enforcer of the Uruguay Round. The WTO was created to support the principles of the GATT and will therefore encourage all countries to strictly adhere to these principles -- to promote rather than hinder the growth in world trade. Farm Bureau policy supports this goal. The WTO needs the support of all Americans if we wish to maintain the principles of the GATT and if we believe that free and open trade is the key to economic success for America and the nations of the world. But to accomplish the current agenda of a more open international trading system, a better program anticipating trade adjustment problems and monitoring and enforcing U.S. trade accords needs to be put into place.

Farm Bureau believes that higher living standards throughout the world depend on mutually beneficial trade among nations. We urge that trade and other economic policies be developed that promote rather than retard the growth in world trade. Current data appear to verify that international trade is becoming even more important for the world economy, which makes the current GATT accord and the existence of the WTO more important as well.

In 1994, U.S. agricultural exports to the world amounted to $43.5 billion. By the end of 1995, this figure had advanced to over $54 billion -- an increase of almost 25 percent. For 1996, the USDA is currently projecting another record year in agricultural exports, approaching $60 billion. During the current year, for each $2 in agricultural exports, the U.S. will import $1 worth of farm commodities -- creating an ag trade surplus in favor of the United States. This is good news for farmers and ranchers and the entire economy.

Our top agricultural exports by commodity are currently being led by grains and feeds, especially corn and wheat. Soybeans, beef, fruit and vegetables will also show solid export sales for 1996. All major farm exports will be steady or up in value from 1994 levels including dairy, tobacco, cotton and sugar -- making our overall trade picture extremely favorable.

Despite a solid export picture, current trade disputes still exist among GATT signatories and there are those who will try to circumvent the GATT agreement. America must remain firm in its commitment to free and open trade. The WTO must be our first line of defense as we seek to maintain that ever-growing need for fairness and stability in the world market.

Farm Bureau policy states: "Our government should insist on strict implementation of international trading rules -- including GATT -- to prevent unfair practices by competing nations and to assure unrestricted access to domestic and world markets." The recent dispute with Russia concerning the potential ban of U.S. poultry is an excellent example where the WTO could be of benefit -- if Russia were a signatory to the accord. Fortunately, the U.S. has several other formal avenues that appear to have helped resolve this specific situation to let U.S. imports flow into this part of the former Soviet Union.

Farm Bureau policy also states that since the passage of GATT, we support better enforcement of import restrictions and enhanced export support from the U.S. government as well as the concepts of like quality inspections for domestic and foreign products. The European Union (EU) ban on American beef treated with growth hormones is another excellent example. This dispute is currently being judged by the WTO and the stance of the United States is that scientific research is on the side of the American producers. This resolution process by the WTO should eventually open European markets to American producers, markets that are arbitrarily closed to us today. In this situation, the WTO will have been invaluable in strictly enforcing the Uruguay Round and its original intent.

The WTO may also be of benefit concerning the surge in imports of wheat gluten to the United States from the EU. The rise in imports may well be the result of trade practices that have impaired the benefits accrued to the United States under the Uruguay Round. The EU tariff and subsidy structure currently keeps U.S. exports out of their market and still floods the U.S. with their wheat gluten. A permanent solution to this matter should be achievable through consultations and negotiations among WTO members.

On January 22, 1996, U.S. and Korean officials announced a successful conclusion to talks on Korean food shelf-life standards. On this basis, the U.S. has decided not to seek a dispute settlement panel under WTO rules. The standards for sterilized milk products, however, have not yet been resolved and could be taken to the WTO at a future date if progress is not made.

Like any good defense, there must be a supporting offense. Those who represent us at the WTO and other ongoing trade negotiations need to be armed with good, hard, scientifically proven facts and figures about our agriculture. They need research and technology to prove unequivocally to the world again and again, that U.S. farmers provide the safest, highest quality food products anybody's money can buy. At the same time, our trade representatives must be confident in assuring a consistent supply line.

Four days ago, I returned home after spending 16 days in Southeast Asia, specifically Vietnam and Indonesia. Together, they have the world's fourth largest population. Only China, the United States and India have more people. These nations not only want our food products, they have the money to pay for them. The economies and personal incomes in these nations are growing at an astounding rate. Their people want more variety in their diet as well as other goods and services that come with an ever-expanding economy. In the case of Indonesia, America has made great strides in providing cotton, corn, wheat and soybeans. But the competition from places like Canada and Australia is fierce. Often times we can only fill the balance of a purchase order because ultimately price makes the sale.

I mention this for two reasons. First, it serves as an example that the provisions of the GATT agreement should be equal for all who signed on the dotted line. That's the job of the WTO, along with the United States Trade Representative (USTR) and the United States Department of Agriculture (USDA). Secondly, those representing us in the world marketplace need the tools of a good marketing program. They need good, reliable information about the marketplace. They need consistent funds, such as the Market Promotion Program, to continue cooperative team efforts that show developing nations first-hand the economic benefits of buying our products. By meeting the food and fiber needs of such nations as Vietnam and Indonesia, peace and social harmony become the norm, not the

exception.

The Uruguay Round of GATT brings international trade in agricultural products under a consistent set of rules for the first time. Effective application of the WTO will greatly benefit the U.S. agricultural sector.

This application should include:

- A monitoring of compliance to the disciplines and commitments agreed upon for agriculture by all WTO members.
- The use of all available tools to ensure full implementation by all WTO members of agreed upon commitments.
- Placing great importance on the continuance of WTO negotiations on agriculture and holding all members to the commitment to make them both comprehensive and substantive.
- Seeking acceleration of commitments when possible.
- Expanding and increasing USDA and USTR mechanisms and efforts for monitoring implementation by country and commodity that represent important markets for U.S. agricultural products.
- Maintaining vigilance to ensure that dispute resolution is not used to undermine the Uruguay Round.
- Seeking to use the WTO as a conciliation process and avoid litigation whenever possible.
- Defending against WTO challenges when the laws in question go against U.S. rights and obligations.

In short, Farm Bureau policy states that, "All trade agreements -- including GATT -- should be continuously evaluated with emphasis on fair trade as well as free trade." Fair trade may be in the eyes of the beholder, but our accords can be monitored to ensure that tariffs are lowered, burdensome regulations are lessened and agreements are strictly enforced.

In closing, let me say that the American Farm Bureau and its member families stand ready to assist the USTR and the USDA whenever, wherever the need may be. To accomplish our goals, Congress can assist the United States Trade Representative's office in implementing a Trade Monitoring Unit to monitor foreign compliance with trade agreements such as GATT and to help implement U.S. trade laws. This unit is already in the implementation process and can be encouraged to include input from industry leaders -- such as the Farm Bureau -- and other governmental departments, especially the Department of Agriculture.

Farm Bureau will work closely with U.S. international trade negotiators in all negotiations on trade to see that all U.S. agricultural products are treated fairly. The WTO and the Uruguay Round of GATT are the current starting points for such a noble goal. Together we can harvest the benefits of good, sound trade policies.

Thank you.

Chairman CRANE. Thank you.
Mr. Cross.

STATEMENT OF AARON W. CROSS, PUBLIC POLICY DIRECTOR, GOVERNMENTAL PROGRAMS, IBM, INC.; ON BEHALF OF INFORMATION TECHNOLOGY AGREEMENT COALITION

Mr. CROSS. Thank you, Mr. Chairman. I do have some additional material for the record.

Mr. Chairman, in December 1995, President Clinton, EU Commission President Jacques Santer, and then-EU Counselor Ministers President Felipe Gonzalez announced at the United States-European summit meeting in Madrid the start of formal negotiations for an ITA, Information Technology Agreement. The ITA would by January 1, 2000, eliminate on an MFN basis all ITA member country tariffs on information technology products. Our Coalition suggests the ITA be formally announced at the Singapore Ministerial Meeting in December of this year.

While tariff elimination is the ultimate goal we seek from the ITA, the motivations for concluding this agreement derive from far broader interest shared by the United States and other countries. The United States and Europe agree the ITA is an important step in demonstrating good faith commitment by all parties involved to the rapid and full deployment of GII, the Global Information Infrastructure, or as it is sometimes called, the international information society.

The GII will give governments, business, and other private sector groups and individual consumers a wide array of information-based services promoting the political, social, and economic goals of all GII users. If the GII is to reach its full potential, all of these services should be made available to all users, including individual consumers, at the lowest possible cost. Eliminating the industrial world's generally low remaining tariffs on IT products will do much to make them more affordable to a broader spectrum of users in both the developed and developing countries in the world.

Since broader GII access is important, treating the ITA as a traditional tariff-cutting exercise where a balance in trade concessions has historically been the goal of negotiations, would be a strategic error. Rather, the ITA should focus on zeroing out tariffs for an entire industry sector in order to meet the political, economic, and social objectives I have mentioned. I am pleased to report that in this we have enjoyed the strong support of the administration and the leadership of both parties in Congress.

My second point addresses the critical role of the Uruguay Round and the WTO structure that it created. Both will be critical success factors for the ITA. The Uruguay Round Agreements provide specifically for plurilateral trade agreements like the ITA, as long as such agreements are on an MFN and national treatment basis. The WTO further provides an umbrella under which these agreements may be expanded to include other WTO countries.

In this regard, it is true that the ITA may sound to some like a limited bilateral agreement since the negotiations start out between the United States and the European Union. However, United States negotiators have signaled their intent that the United States-European Union negotiation, while it is targeted initially as

the first element in a plan to win ITA support from all of the Quad countries encompassing Japan and Canada as well, that the Quad Agreement will then serve as an overall outline for the ITA and thereby set a stage for work in the second half of this year to get agreement by other world countries including those from APEC, Latin America, and Africa.

The WTO umbrella for the ITA is important as well since there are a number of detailed issues that are essential as to whether the ITA will succeed. Specifically, I would like to draw your attention to our concerns about a number of technical decisions in the area of Customs classification by the European Commission's DG–XXI. As the Members of this Subcommittee know well, the technology in our industry continues to be unveiled at a breathtaking pace. This IBM Thinkpad computer I have here has the ability not only to do traditional computing applications, but it also has the capability of performing as a fax machine, telephone, television, and radio. In short, it is a true multifunctional computer.

DG–XXI has made a number of Customs classification decisions in recent months on these and related products that erroneously, we believe, misclassify them into higher tariff rate telecommunications and consumer electronics categories. We strongly believe products like this Thinkpad computer should be classified as what they are—computers.

I should mention as well we have a number of related concerns about similar technical decisions that are pending in Europe in the area of Customs valuation of software. Because the WTO permits trade negotiators to conclude plurilateral agreements like the ITA in ways that more closely reflect the long-term national interest of the WTO member States, we have an opportunity to have these important issues resolved at a policy level.

Even after the ITA is successfully negotiated, these technical issues will continue to arise, especially as our product technology continues to evolve. The WTO's institutional framework offers a significant opportunity, both during the negotiation of the ITA and after its implementation, to resolve these issues without having to resort to formal dispute settlement procedures.

If I may conclude on a personal note, Mr. Chairman. I would like to say how fortunate I am to appear here as a representative of my industry. Our industry is known for vision, optimism, and its global outlook. It is an exciting one and often difficult to keep track of technology like what I am talking about here today. But the innovation it produces is the lifeblood of our industry, and the overall health of the U.S. information technology industry is better now than it has ever been at any time in its history.

I would be remiss if I overlooked the support we have had from our elected leaders who have demonstrated similar foresight. The Members of this Subcommittee, through their support for the WTO, the Uruguay Round, and the NAFTA, have fostered an environment that has permitted our industry to lead the world as we strive toward realization of the GII. I hope you will therefore convey to Mr. Gibbons our sadness about his retirement and our appreciation for the outstanding record he has had, along with the gentlemen here, who are here at present.

As we look ahead, Mr. Chairman, we, the members of the ITA Coalition, will be counting on you and the other Members of the Subcommittee for your support for the ITA, for the WTO, and for your continued support for a forward-looking trade policy. We are asking you to express your strongest support to Ambassador Kantor for a good Information Technology Agreement. We hope you will make every effort to speak out about the benefits of the ITA at every opportunity this year.

Thank you for your time.

[The prepared statement follows:]

Prepared Remarks of Aaron W. Cross
U.S. Co-Chairman, Information Technology Agreement Coalition

Mr. Chairman, I am Aaron Cross, Public Policy Director in IBM's Governmental Programs office in Washington. Today, I am appearing in my capacity as the United States co-chairman of the Information Technology Agreement Coalition, or ITAC. Led jointly by the Information Technology Industry Council and the American Electronics Association, ITAC is a group of nine American high technology industry associations and a growing number of companies who are working to promote the international negotiation of the Information Technology Agreement, or ITA. With your agreement, Mr. Chairman, we ask that supporting materials about the ITA and our coalition introduced into the hearing record.

In December of 1995, President Clinton, EU Commission President Jacques Santer and then EU Council of Ministers President Felipe Gonzalez announced at the United States/European Union summit meeting in Madrid the start of formal negotiations for an Information Technology Agreement. The ITA would by January 1st, 2000, eliminate -- on an MFN basis -- all ITA member country tariffs on information technology products, including computer hardware and software, semiconductors and integrated circuits, and telecommunications equipment. ITAC suggests that the ITA be formally announced at the Singapore Ministerial meeting of the WTO in December of this year.

While tariff elimination is the ultimate goal that we seek from the ITA, the motivations for concluding this agreement derive from broader interests shared by the United States and other countries.

The United States and Europe agree that the ITA is an important step in demonstrating good faith commitment of all parties involved to the rapid and full deployment of the Global Information Infrastructure, or as it is sometimes called, the International Information Society. The GII will give governments, business, other private sector groups, and individual consumers a very wide array of information-based services promoting the political, social, and economic goals of all GII users. For example, the GII will produce better access to high quality health care services, enhanced educational opportunities, improved business and manufacturing efficiency, better logistics and distribution systems, improved labor productivity, and the promotion of democratic ideas -- and these are just to name a few of the GII's benefits.

If the GII is to reach its full potential, all of these services should be made available to all users, including individual citizens, at the lowest possible cost. Eliminating the industrialized world's generally low remaining tariffs on information technology products will do much to make them more affordable to a broader spectrum of users in both the developed and developing countries of the world. Since broader GII access is so important, treating the ITA as a traditional tariff cutting exercise -- where balance in trade concessions has historically been the goal of negotiators -- would be a strategic error. Rather, the ITA should focus on zeroing out tariffs for an entire industry sector in order to meet the political, economic, and social objectives I have mentioned. I am pleased to report that, in this, we have enjoyed the strong support of the Administration and the leadership of both parties in Congress.

My second point addresses the critical role of the Uruguay Round and the WTO structure that it created. Both will be critical success factors for the ITA. The Uruguay Round agreements provide specifically for plurilateral trade agreements as long as such agreements are made on an MFN and National Treatment basis. The WTO further provides an umbrella under which these agreements may be expanded to include other WTO countries, hopefully, to the point where all WTO members will eventually join the ITA.

In this regard, it is true that the ITA may sound to some like a limited bilateral agreement. However, U.S. negotiators have signaled their intent that the U.S./E.U. negotiation is targeted initially as the first element in a plan to win ITA support from all of the Quad countries, encompassing Japan and Canada as well. Our hope is that Quad agreement by sometime this summer on the overall outline of an ITA will set a stage for work in the second half of this year to get agreement by other world regions -- such as the APEC countries, the Latin American countries, African, and other countries -- to announce their endorsement of the ITA at the time of the WTO Ministerial meeting in December.

The WTO umbrella for the ITA is important, as well, since there are a number of detailed issues that are essential to whether the ITA will succeed. Specifically, I would like to draw your attention to our concerns regarding a number of technical decisions in the area of customs classification by the European Commission's DG-21. As the members of this subcommittee know well, the technology in our industry continues to be unveiled at a breathtaking pace. The IBM Thinkpad computer I have with me today has the ability not only to do "traditional" computing applications, but it also has the capability of performing as a fax machine, a telephone, a television, a radio -- in short, it is a true multifunctional computer.

DG-21 has made a number of customs classification decisions in recent months on these and related products that, erroneously, we believe, misclassify them into higher tariff rate telecommunications and consumer electronics categories. We strongly believe that products like this Thinkpad computer should be classified as what they are -- computers, and therefore subject to a lower tariff rate. I should mention, as well, that we have a number of related concerns about similar technical decisions that are pending in the area of the customs valuation of software. Because the WTO permits trade negotiators to conclude plurilateral agreements like the ITA in ways that more closely reflect the long term national interests of the WTO's member states, we have an opportunity to have these important issues resolved at a policy level.

Even after the ITA is successfully negotiated, these technical issues will continue to arise, especially as information technology products continue to evolve. The WTO's institutional framework offers a significant opportunity -- both during the negotiation of the ITA and after is implementation -- to resolve these issues without having to resort to formal dispute settlement procedures.

I'd like to conclude, Mr. Chairman, on a personal note. I am fortunate to appear today as a representative of my industry. This industry is known for its vision, its optimism, and its global outlook. It's an exciting one, and it's often difficult to keep up with what's happening in my own company, to say nothing of what's happening in the rest of the industry. Innovation is the lifeblood of our industry, and the overall health of the U.S. information technology industry is better now than it has been at any time in our history.

I would be remiss, however, if my statement overlooked the support we've had from our elected leaders who have demonstrated similar foresight. The members of this subcommittee, through their support for the WTO, the Uruguay Round, and the NAFTA, have fostered an environment that has permitted our industry to lead the world, as we strive toward realization of the Global Information Infrastructure. We are therefore sad to learn that Mr. Gibbons is retiring. He has a remarkable record, both as Chairman and Ranking Member, of demonstrating leadership and foresight in setting this country's trade policy agenda.

As we look ahead, Mr. Chairman, we the members of the ITA Coalition will be counting on you and the other members of the subcommittee for your support for the ITA, for the WTO, and for your continued support for a forward-looking United States trade policy. We're asking you to express your strongest support to Ambassador Kantor for negotiation of a good Information Technology Agreement. We hope you will make every effort to speak out about the benefits of the ITA at every opportunity this year.

Thank you and I will be happy to answer any of your questions.

Chairman CRANE. Thank you, Mr. Cross.
Jim.

STATEMENT OF HON. JIM SLATTERY, PARTNER, WILEY, REIN & FIELDING; ON BEHALF OF WHEAT GLUTEN INDUSTRY

Mr. SLATTERY. Thank you, Mr. Chairman. It is great to see you all. I appreciate the opportunity to appear before you today and I commend you, Mr. Chairman, for calling this hearing.

There is no doubt that a number of American businesses have benefited significantly from the Uruguay Round Agreements, but there are some businesses that have not fared quite so well through no fault of their own and today I am here to represent one of those industries.

The Wheat Gluten Industry is a small industry by global standards, but it is critically important to U.S. wheat farmers, the banking industry, pet food manufacturers, cereal processors, and the American families that depend on production facilities for their jobs. Wheat gluten is the natural protein portion of wheat that is extracted after wheat is milled into flour. Wheat starch is produced as a coproduct. In its finished form, wheat gluten is a fine, tan powder consisting of approximately 75 to 80 percent protein.

The European wheat starch gluten processing program is a case study on how huge foreign business interests acting in close cooperations with their governments can destroy American businesses. The U.S. wheat gluten producers are not competing against foreign businesses; they are competing against foreign governments even after the Uruguay Round.

Here is the situation. The European Union imposed import tariffs of approximately $1,000 per metric ton on edible wheat gluten during 1995. The comparable U.S. tariff was approximately $85 per metric ton. The European Union also imposed import tariffs on the coproduct, wheat starch, of approximately $470 per metric ton. The comparable U.S. tariff was $10 per metric ton. Believe it or not, under the Uruguay Round Agreements, European Union tariffs were allowed to go up while the United States tariffs were required to be lowered.

The combination of import tariffs on starch and gluten, coupled with the European Union refunds paid to domestic users of starch have made it possible for European producers to sell starch within the European Union for 2½ times the world price during most of 1995. The European Union tariffs make it impossible for United States producers or other non-European producers to sell starch or gluten in the European Union. Thus, European producers have a totally protected market.

When European producers are able to sell starch for 2½ times the world price, they are making huge profits which are used to discount the price of the coproduct, gluten. The European producers have, in effect, developed an elaborate cross-subsidization system that enables them to dump gluten in the United States market at prices well below the United States cost of production.

These tariff barriers and subsidy programs have stimulated a sharp increase in European production capacity and exports of wheat gluten to the United States which are destroying United States markets and injuring United States producers. Based on Eu-

ropean Starch Association estimates, exports of wheat gluten from the European Union will increase an additional 265,000 metric tons by the year 1999, even without production quantities from new European Union member countries like Sweden, Finland, and Austria. This projected increase is more than two times the total U.S. consumption for 1995.

If the European Union producers are able to continue to enjoy the benefits of a totally protected domestic market that enables them to sell starch at 2½ times the world price, and dump the co-product gluten in the United States market at prices well below the U.S. cost of production, United States producers will be forced out of business. Once the European Union unfairly pushes the United States producers out of the market they will be able to set the price of wheat gluten in the United States. As incredible as it sounds, the European Union could be in the position of imposing a bread tax on American consumers.

Many American farmers have become alarmed by the actions of the European Union. They know that vital wheat gluten is a direct replacement and alternative to high protein wheat. The decision a flour miller or baker makes in determining how to raise flour protein levels and performance is based purely on economics. They simply want to know where they can buy protein for the lowest price. Subsidized European Union gluten is a clear and present threat to high protein premiums paid to United States wheat farmers.

There is a solution to this problem. The Uruguay Round must not be viewed as the final trade agreement with the European Union. The U.S. Government must work constantly to enforce and improve existing trade agreements. Simply stated, the solution to the problem is the equalization of tariffs and levies between the European Union and the United States. This would stop artificial and excessive wheat starch profits from being used to subsidize the export of wheat gluten to the United States.

In the meantime, it is absolutely essential our government negotiate a solution with the European Union that will protect United States gluten producers and wheat farmers from being further damaged by the current unfair trade practices of the European Union. The wheat gluten industry is grateful that Ambassador Kantor and Secretary Glickman have successfully negotiated inclusion of a provision in the recent agreement that obligates the European Union and the United States to formally consult with a commitment to find a mutually satisfactory solution to this problem if European Union imports exceed the 1990–92 level. And that was done in 1995.

The industry is anxiously awaiting the commencement of formal consultations and, hopefully, a mutually satisfactory solution can be achieved. The alternative is the unacceptable destruction of an important U.S. industry or costly litigation.

Thank you, Mr. Chairman, for the opportunity to testify. I know I am the last witness here today, and I am mindful you all have had a long day probably and I appreciate your attendance.

[The prepared statement follows:]

STATEMENT OF HON. JIM SLATTERY
PARTNER, WILEY, REIN & FIELDING
ON BEHALF OF WHEAT GLUTEN INDUSTRY

Mr. Chairman, I am very pleased to have this opportunity to testify before the House Ways & Means Trade Subcommittee.

I commend you, Mr. Chairman, for holding this hearing on the Uruguay Round Agreements.

There are surely a number of businesses that have benefitted from the Uruguay Round Agreements. But there are some U.S. businesses and industries that have not fared well through no fault of their own.

I am representing one of those industries today.

The U.S. Wheat Gluten industry is a small industry by global standards, but it is critically important to U.S. wheat farmers, the baking industry, pet food manufacturers, cereal processors, and the American families that depend on production facilities for their jobs.

Wheat gluten is the natural protein portion of wheat that is extracted after wheat is milled into flour. Wheat starch is produced as a co-product. In its finished form, wheat gluten is a fine tan powder consisting of approximately 75-80 percent protein.

The European wheat starch/gluten processing program is a case study on how huge foreign business interests acting in close cooperation with their governments can destroy American businesses. U.S. wheat gluten producers are not competing against foreign businesses, they are competing against foreign governments. This is the case even following the Uruguay Round Agreements.

Here is the situation.

The European Union imposed import tariffs of approximately $1,000 per metric ton on edible wheat gluten during 1995. The comparable U.S. tariff was approximately $85 per metric ton. The European Union also imposed import tariffs on the co-product, wheat starch, of approximately $470 per metric ton, compared to $10 per metric ton in the United States. Believe it or not, but under the Uruguay Round Agreements, European Union tariffs were allowed to go up while U.S. tariffs were required to be lowered.

The combination of import tariffs on starch and gluten, coupled with European Union refunds paid to domestic users of starch, have made it possible for European producers to sell starch within the European Union for 2½ times the world price during most of 1995.

The European Union tariffs make it impossible for U.S. producers and other non-European producers to sell starch or gluten in the European Union. Thus, European producers have a totally protected market!

When European producers are able to sell starch for 2½ times the world price, they are making huge profits which are used to discount the price of the co-product gluten. The European producers have in effect developed an elaborate cross subsidization system that enables them to dump gluten in the U.S. market at prices well below the U.S. cost of production.

These tariff barriers and subsidy programs have stimulated a sharp increase in European production capacity and exports of wheat gluten to the United States which are distorting U.S. markets and injuring U.S. producers.

Based on European Starch Association estimates, exports of wheat gluten from the European Union will increase an additional 265,000 metric tons by the year 1999, even without production quantities from new European Union member countries like Sweden, Finland and Austria.

This projected increase is more than 2 times the total U.S. consumption for 1995.

If the European producers are able to continue to enjoy the benefits of a totally protected domestic market that enables them to sell starch at 2½ times the world price and dump the co-product gluten in the U.S. market at prices below the U.S. cost of production, U.S. producers will be forced out of business.

Once the European Union unfairly pushes the U.S. producers out of the market, they will be able to set the price of wheat gluten in the United States.

As incredible as it sounds, the European Union could in effect impose a bread tax on American consumers.

Many American wheat farmers have become alarmed by the actions of the European Union. They know that vital wheat gluten is a direct replacement and alterative to high protein wheat. The decision a flour miller or baker makes in determining how to raise flour protein levels and performance is based on pure economics. They simply want to know where they can buy protein for the lowest price.

The formula used for making the decision is based on the simple fact that 1.6 lb. of wheat gluten added to 98.4 lb. of wheat flour will raise the protein of that 100 lb. of flour by 1 percent (e.g., 11 percent flour to 12 percent flour) (about 2.3 bu. of wheat are used to produce 100 pounds of flour).

Subsidized European Union gluten is a clear and present threat to high protein premiums paid to U.S. wheat farmers. Historically, these premiums have ranged from 25¢/bu. to $1.25/bu. depending on weather and market conditions.

* * *

There is a solution to this problem.

The Uruguay Round must not be viewed as the final trade deal with the European Union.

The U.S. government must work constantly to enforce and improve existing trade agreements.

Simply stated, the solution to the problem is the equalization of tariffs and levies between the European Union and the United States. This would stop artificial and excessive wheat starch profits from being used to subsidize the export of wheat gluten to the United States.

It would also provide the United States and other non-European producers of starch and gluten access to the currently closed European market.

In the meantime, it is absolutely essential that our government negotiate a solution with the European Union that will protect U.S. gluten producers and wheat farmers from being further damaged by the current unfair trade practices of the European Union.

The wheat gluten industry is grateful that Ambassador Kantor and Secretary Glickman have successfully negotiated inclusion of a provision in the recent enlargement talk agreement that obligates the European Union and the United States to formally consult with a commitment to find a mutually satisfactory solution to this problem, if European Union imports exceed the 1990-1992 level.

That level was exceeded in 1995.

The industry is anxiously awaiting the commencement of formal consultations and hopefully a mutually satisfactory solution can be found.

The alternative is the unacceptable destruction of an important U.S. industry or costly litigation.

Thank you again, Mr. Chairman, for the opportunity to testify. I would also like to submit several documents for the record.

Chairman CRANE. Thank you for your testimony.

Amo.

Mr. HOUGHTON. Thank you, gentlemen. I have a lot of questions but I am only going to ask one, and that is really of Mr. Rigolizzo. I would be interested in following this wheat gluten concept. Obviously, something went astray between the Uruguay Round and what was intended and what actually has happened. How did that get off the track? How do we get it back on the track? That is important. Also the reclassification of a Thinkpad from a telephone or a fax machine into a computer. Maybe we can talk about that at another time.

I guess what I would like to do is to ask Mr. Rigolizzo about the increase of the agricultural industry, particularly in exports, between 1994 and 1995; a 25-percent increase, very impressive. Of course, it has always seemed to me, when you are talking trade negotiations you are not only talking fairness but you are talking about the possibilities for growth. What do you do for growth?

Are the growth opportunities in accordance with our trade practices and laws there for the dairy industry as they are for a variety of other industries, particularly the grain industry? Maybe you would like to comment on that.

Mr. RIGOLIZZO. Yes, sir, I think they are. Like I said, I just came back from Vietnam and Indonesia. I was there on a trade mission with the American Farm Bureau president. In regards to dairy, both nations can only produce about 10 percent of their milk needs. The people are demanding a whole lot more. Currently, some of those needs are being filled by powdered milk sent from the United States.

However, let me say this, they have been concentrating the last few years on developing their dairy genetics, and they have done a pretty good job. But they just do not have the feed like alfalfa and clover, the good feed those animals need to bring out the best of their genetics. In fact, we were discussing this at home last night. The simplest, easiest solution would be to—rather than help them or send them feed to produce their own milk—send some of ours. In my State, in New Jersey the dairy industry is hurting. It is one of our biggest and saves the most open space, but we just cannot keep our dairy farmers on the farm because they are not getting enough for their product.

One of the simplest ways would be to start being able to ship fresh milk to the Southeast Rim. We can do that now because we have, in our own State, dairy processing plants that have shipping capabilities of keeping fresh milk, not only 1 week like we get it on the shelf in the store, but for 45 and 60 days. So we can actually send it by ship and they can bottle it over there and sell it on their own market.

Mr. HOUGHTON. Fine, thanks very much.

Thank you, Mr. Chairman.

Chairman CRANE. Mr. Rangel.

Mr. RANGEL. Let me thank all of you for your presentation and your patience in waiting so you could be heard.

Chairman CRANE. I want to express appreciation to you, too. Please maintain the channels of communication. There is going to be an ongoing dialog on many of these issues. I was kind of overwhelmed, Jim, at your testimony there about the tariff levels on EU imports of wheat gluten. But I appreciate it all and we are grateful to you for coming today. Your full statements will be a part of the permanent record.

With that, the Subcommittee stands adjourned.

[Whereupon, at 5:08 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF ANSAC BEFORE THE TRADE SUBCOMMITTEE OF THE HOUSE COMMITTEE ON WAYS AND MEANS REGARDING FUTURE U.S. TRADE POLICY INITIATIVES

INTRODUCTION

This statement is filed by ANSAC, headquartered in Westport, Connecticut, in response to the February 7, 1996, House Ways and Means Committee invitation for public comments related to Trade Subcommittee hearings on the status and future direction of US trade policy, including possible new trade agreements.

ANSAC, a Webb-Pomerene Association wholly-owned by the six US soda ash producers, is the sole authorized US soda ash exporter. Soda ash is a basic chemical commodity required to manufacture glass and generally accounts for one-half of the cost of molten glass production. The United States has a unique natural deposit of a raw material (trona) for soda ash located in Green River, Wyoming, from which this country could supply world demand for 1,200 years. Most other countries produce soda ash through a synthetic process at costs many times higher and with major environmental pollution. The US soda ash industry is responsible for over 20,000 jobs.

This paper highlights ANSAC's interest in the Trade Subcommittee hearings, which is confined to post-Uruguay Agreement efforts to eliminate tariffs on US soda ash exports, specifically within the Asia-Pacific Economic Cooperation (APEC) process. The Uruguay Round Agreement Statement of Administrative Action specifically identifies soda ash as a "zero-for-zero" sector priority. In the short term, an APEC "standstill" commitment not to increase tariffs above applied rates is critical in order to prevent countries establishing a local soda ash industry (e.g., Indonesia) from significantly raising their tariffs to protect local production.

The US soda ash industry is increasingly dependent on APEC trade for growth and thus has a critical interest in APEC trade liberalization. Zero-for-zero tariff elimination among APEC members would yield substantial benefits to the US soda ash industry, which has seen domestic sales decline in recent years. Over the past five years, US soda ash exports to the APEC countries have increased nearly 40 percent, and now account for 62 percent of total US exports. Duty-free access to APEC markets would result in estimated new US soda ash exports of $1.1 billion by the year 2000 -- a *245 percent increase* over last year's exports -- and roughly 9,200 new US jobs, primarily in Wyoming.

I. GOALS.

- **A commitment from APEC countries (particularly Indonesia) not to increase tariffs on soda ash imports above 1995 applied rates.**
- **Tariff elimination and WTO bindings to zero in all APEC countries.**
- **Tariff elimination and WTO bindings to zero by all APEC countries seeking to join the WTO (i.e., China, Taiwan and conceivably Vietnam).**

II. SODA ASH AS A ZERO-FOR-ZERO SECTOR.

The Statement of Administrative Action ("SAA") implementing the Uruguay Round Agreement outlined the objectives of zero-for-zero tariff elimination in key sectors, including soda ash. According to the SAA, "in some sectors, namely ...soda ash..., complete duty elimination was not achieved. Obtaining further reductions in these sectors is a priority objective for US multilateral regional and bilateral negotiations." It is requested that the Presidential residual negotiating authority be used to achieve the market access priorities identified above.

III. ABOUT SODA ASH AND THE US INDUSTRY.

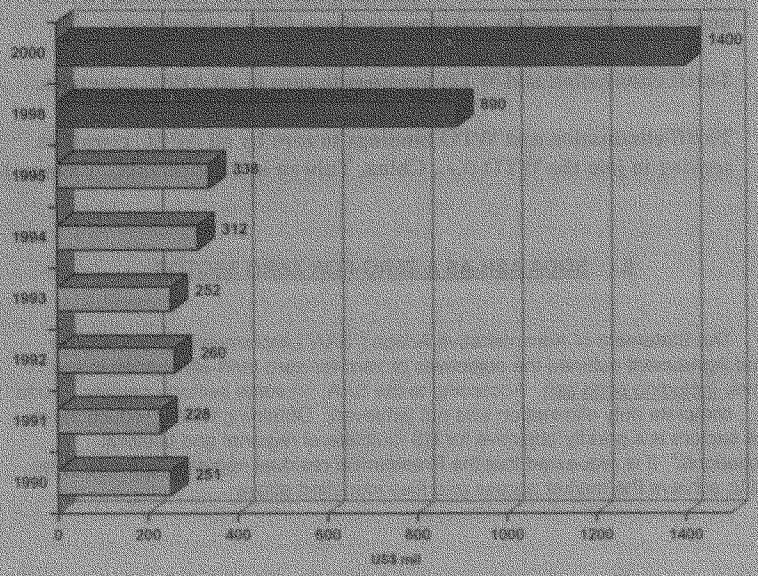
Soda ash (disodium carbonate) is the principal raw material for making glass. Mixing six parts sand to one part soda ash and heating it to 2800 degrees yields molten glass which can be formed into any common application. The United States is blessed with unique natural deposits of trona, a soda ash raw material, in Green River, Wyoming and Trona, California, from which this country could supply world demand for 1200 years.

US soda ash is the most competitive in the world. Most other countries produce soda ash through a synthetic process at costs many times higher and with major environmental pollution. However, US soda ash is restricted in many foreign markets principally through tariff barriers. Because soda ash is a basic chemical commodity required to make another basic commodity, glass, even a 0.5 percent premium in price can make the difference between a sale. In 1995, US soda ash exports were 3.5 million metric tons (MT) valued at approximately $545 million. All told, the US soda ash industry is responsible for over 20,000 US jobs.

IV. US SODA ASH EXPORTS TO APEC COUNTRIES.

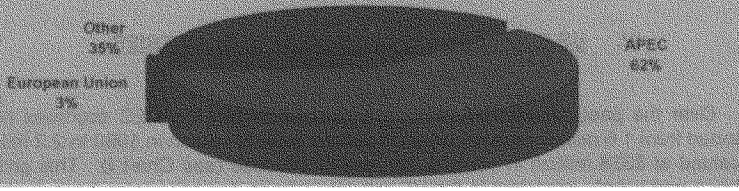
Over the past decade, US soda ash exports to the 18 APEC countries have expanded from 1.6 million metric tons (MT) valued at $226 million in 1990 to 2.2 million MT valued at $338 million in 1995, a 38 percent increase (*see* Chart I). This growth has been particularly important to the US industry, whose domestic sales have declined over the last ten years. All told, APEC exports account for 12,500 US jobs.

I. US Soda Ash Exports to APEC Countries and Potential Growth from Zero-for-Zero



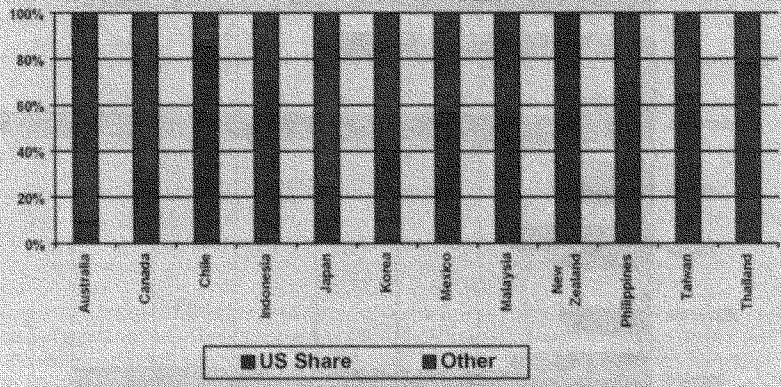
US exports to APEC countries now account for 62 percent of US exports (see Chart II). Though US soda ash is the most competitive in the world, it satisfies only 22 percent of aggregate demand in the 17 other APEC countries (see Chart III). This share should be much higher, but it is hindered by tariff barriers (China and Korea) and non-tariff barriers (Japan). Soda ash exports to the APEC countries are expected to increase dramatically from 2.2 million MT valued at $340 million to 3.5 million MT valued at $685 million by the year 2000. With duty-free access to APEC markets unhindered by non-tariff barriers, this number would soar to 7.6 million MT valued at $1.4 billion -- a 245 percent increase over current US exports to APEC (see Chart I). In order to fill this demand, 9,200 US jobs would be created.

II. 1995 US Soda Ash Exports to APEC and the World



Soda ash is currently produced in seven of the 18 APEC nations, not including the US. A soda ash plant is under construction in Indonesia, and there is potential of local production in Thailand. All current or prospective soda ash production in these APEC countries use the synthetic manufacturing process with higher costs than natural US soda ash. Thus, establishment of a local soda ash industry will in all likelihood require significant import protection (i.e., high tariffs) to be competitive with US soda ash or shut out US exports completely.

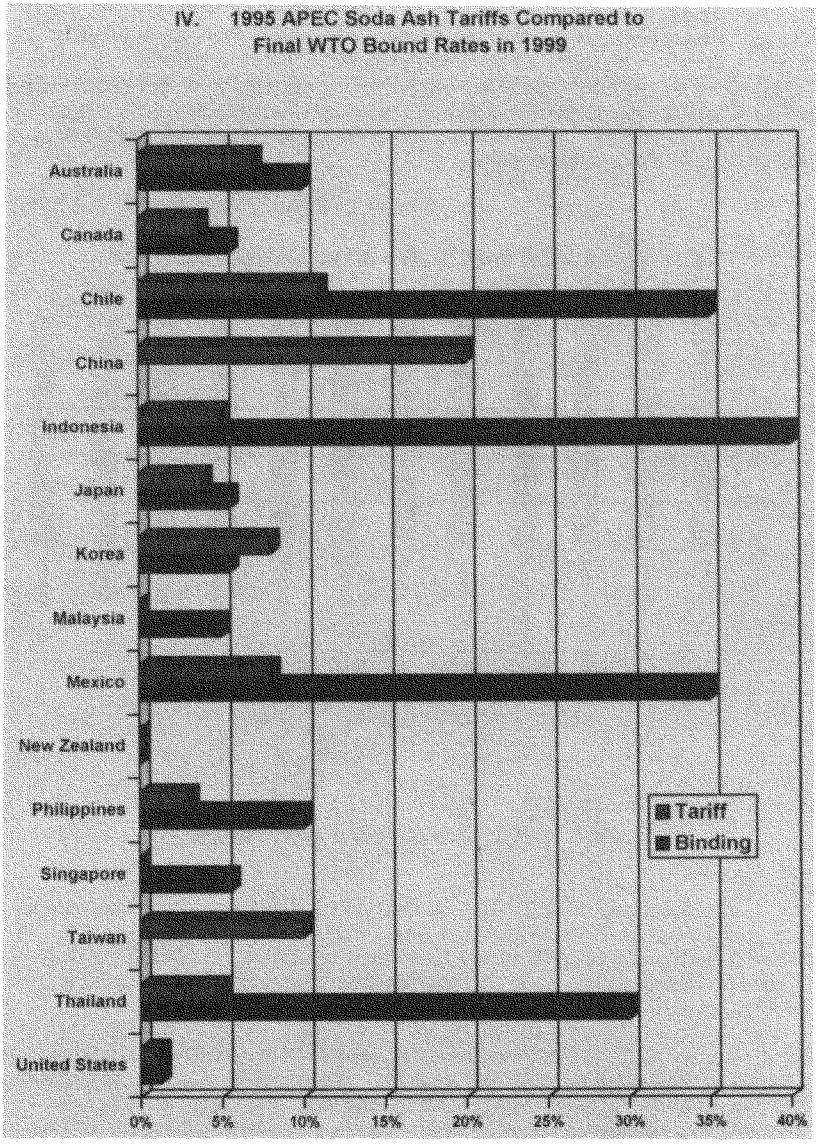
III. US Shares of APEC Soda Ash Demand by Country, 1995



V. APEC TARIFFS AND WTO BINDINGS.

With the exception of China, soda ash tariffs in APEC economies are relatively low, ranging from duty-free in Malaysia, New Zealand and Singapore to 14 percent in China (see Chart IV). The US rate is 1.2 percent *ad valorem*. Generally, the Uruguay Round was disappointing to the US soda ash industry in that improved market access to APEC markets was not achieved.

Current APEC tariffs are already at or below the final WTO bound rates effective in 1999 with the exception of Korea, which has agreed to reduce its 8 percent rate to 5.5 percent by 1999 (see Chart IV). The US and New Zealand are the only other countries that bound their duties at currently low levels. China and Taiwan are not WTO members, though they are in the process of applying. *Of greatest concern is the possibility that Indonesia will increase its current five percent tariff to the WTO bound rate of 40 percent with the development of a local soda ash facility.* Considerable losses to US exports are also at risk if Thailand and Malaysia were to raise their soda ash tariffs to the WTO-legal limit.


IV. 1995 APEC Soda Ash Tariffs Compared to Final WTO Bound Rates in 1999
Australia
Canada
Chile
China
Indonesia
Japan
Korea
Malaysia
Mexico
New Zealand
Philippines
Singapore
Taiwan
Thailand
United States
Tariff
Binding
0%
5%
10%
15%
20%
25%
30%
35%
40%

VI. PRIORITY APEC COUNTRIES FOR ZERO-FOR-ZERO.

A. China

China's recent unilateral reduction in the soda ash tariff from 20 to 14 percent sends a positive signal to the US industry. China is by far the largest soda ash market in APEC -- 1995 consumption totaled more than 5 million MT. However, the US industry supplied less than one percent of this demand. With reciprocal tariff elimination under the APEC, US soda ash exports would immediately increase by 3.5 million MT valued at $660 million.

B. Indonesia

Considering the development of an infant local soda ash industry in Indonesia, at a minimum it is critical that Indonesia agree not to increase its soda ash tariff above the current five percent rate. Ultimately, a WTO binding at five percent would minimize the risk that Indonesia will raise its soda ash tariff to its WTO limit of 40 percent in order to protect local production from more competitive imports. Complete duty elimination under "zero-for-zero" would result in a 50 percent increase in US exports (300,000 MT) valued at $62 million.

C. Korea

Elimination of the Korean soda ash tariff would result in a 150 percent increase (400,000 MT) in US soda ash exports to Korea valued at $84 million.

D. Australia

Elimination of the seven percent Australian duty would result in a five-fold increase (150,000 MT) in US soda ash exports valued at $23 million.

E. Thailand

Thailand's WTO binding of 30 percent offers poses a significant risk to US exports from an unexpected tariff increase. At a minimum, it is important that Thailand also agree to a "stand-still" provision" and bind its five percent duty at that level, in conjunction with seeking complete duty elimination.

SUPPLEMENTAL WRITTEN STATEMENT OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE SUBMITTED TO THE WAYS AND MEANS TRADE SUBCOMMITTEE OF THE U.S. HOUSE OF REPRESENTATIVES ON THE IMPLEMENTATION OF THE URUGUAY ROUND AGREEMENTS AND THE WORLD TRADE ORGANIZATION (WTO)

March 13, 1996

ECAT appreciates the opportunity to present its supplemental written statement to the Trade Subcommittee on the implementation of the Uruguay Round Agreements and the World Trade Organization (WTO). ECAT is an organization of the heads of leading U.S. firms representing all major sectors of the U.S. economy. Their annual worldwide sales total over $1 trillion and they employ approximately 5 million persons. ECAT companies, along with their employees, have prospered under the global trading system developed under U.S. leadership over the past half century. It cannot be overstated that continuance of the multilateral institutions on which it is based is of critical importance to the U.S. economy as a whole.

Without U.S. leadership, global trade liberalization could be dramatically slowed. ECAT is concerned that public support for such U.S. leadership is being undermined by the rising criticism by some political figures of the WTO and trade expansion. It is essential that we in the business community explain the substantial economic benefits that flow from open trade and the institutions that undergird it. We need to forcefully respond to the arguments of critics who decry global trade institutions as a threat to U.S. sovereignty and employment by pointing out that it is the United States itself that has championed global trade liberalization since World War II and has seen the vast expansion of its economy as a result.

The United States must exercise its leadership role to support the WTO's operation in a way that provides for its greatest success. To ECAT this entails promoting an agenda for the first Ministerial meeting which focuses on the implementation of agreements, the completion of unfinished negotiations, and the initiation of discussions on new issues on which there is some basis for international consensus. It also means promoting the broadest possible membership in the WTO to encompass all major trading nations including China based on commercially meaningful protocols of accession.

Finally, the maintenance of U.S. global leadership requires the extension of the President's fast track negotiating authority unencumbered by non-trade-related labor and environment conditions.

The following paragraphs outline ECAT's views on each of these points.

I. Importance of the WTO to Global Trade Expansion

At a time when the economic benefits of the WTO and a liberalized trade regime are being challenged it is important to remind ourselves of the origin of that regime and the dire economic consequences that it was intended to remedy. In 1930, the United States confronted global depression by walling itself in with the enactment of the disastrous Smoot-Hawley tariffs under which trade collapsed, the depression in the U.S. economy deepened, and millions of American suffered. Having endured the painful consequences of shutting off its markets, the United States led the effort after World War II under the Bretton Woods Agreement to establish permanent multilateral institutions and rules to promote global trade expansion through the creation of the World Bank, the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT).

Capped by the historic 1994 Uruguay Round Agreement and creation of the WTO, the multilateral trading system founded after World War II has created the longest sustained period of prosperity in the history of the world. Over the last 50

years, global tariffs have been cut by 85 percent and world trade has grown by more than 5,000 percent. Under the Uruguay Round Agreements these benefits will continue to multiply as the Round's $744 billion in tariff cuts and other liberalization measures are expected to result in an increase of $750 billion in world merchandise trade alone by the year 2005. The number of nations participating in the global system has also increased over time from the original 27 countries that negotiated the GATT agreement in 1947, to the more than 117 countries that have become WTO members.

The establishment of the WTO has further strengthened world trading rules and reinforced the institutional foundation of the world trading system in several ways. First, the WTO reinforces the multilateral dispute settlement system by creating a single dispute settlement body with tighter time deadlines that no longer allow countries found to be flouting the rules to block the adoption of panel reports. The creation of such a dispute resolution system has been a long and bipartisan goal of U.S. trade policy. This stronger dispute settlement mechanism makes it much more likely that U.S. commercial interests will be protected in the trading system and that all countries will comply with WTO obligations. Second, by combining all the GATT and Uruguay Round Agreements under a single institutional framework under which members must adhere to virtually all GATT rules and trade agreements, countries will no longer be allowed to selectively adhere to GATT agreements, thereby enjoying a "free ride." Finally, the WTO formalizes the Trade Policy Review Mechanism (TPRM) which also will enhance compliance with WTO obligations since WTO member states know that their implementation of WTO obligations will be periodically reviewed.

The creation of the WTO framework itself is also an important addition to the institutional foundation of the multilateral trading system. Since 1947, the GATT had operated as a series of agreements without an institutional or organizational base. The WTO finally transforms the GATT agreements into a permanent international institution on par with the World Bank and IMF.

While strengthening the multilateral system, the creation of the WTO in no way impinges on U.S. sovereignty. Compliance with the decisions of the WTO's dispute settlement body is voluntary. It is up to the United States to decide whether it wishes to comply with an adverse decision and amend its laws. If the United States does not wish to do so, the complaining WTO member country can either request compensation from the United States or retaliate. The United States can choose how it wishes to respond to such demands or actions, including a decision to withdraw from the WTO on proper notice.

Having outlined the key ways in which the WTO is vital to the multilateral trade regime, it is important to examine the ways in which it benefits the United States economy.

II. Benefits of an Open Global Trading System and the WTO to the U.S. Economy and its American Workers

The global trade expansion made possible under the GATT agreements and WTO has and will continue to produce substantial benefits to the U.S. economy and American workers. As a result of U.S. trade negotiations, U.S. exports have grown since 1945 at a faster rate than domestic output. As a consequence, trade now accounts for over one quarter of the value of what the United States produces.

The Uruguay Round Agreements are expected to have specific benefits for the U.S. economy, adding between $100 and $200 billion to the U.S. gross domestic product over the next ten years. As we have just finished the first year of implementation of the Agreements, it is difficult to identify precisely their economic impact. However, the overwhelmingly positive U.S. export figures for 1995 indicate that the global trading system is yielding highly favorable results for the U.S. economy. Indeed, the United States has now regained its position as the world's

largest exporter, surpassing Germany. The United States is also the world's number one producer of automobiles for the first time since the early 1970's. The World Economic Forum in 1995 has deemed the U.S. economy to be the most competitive in the world for two years in a row, rising from being ranked in fifth place in 1992.

Last year was a particularly spectacular year for U.S. exports. According to the just-released 1995 Department of Commerce trade figures, U.S. exports of merchandise increased by over $75 billion in 1995, for a total of $577 billion in annual exports, accounting for the largest export growth in U.S. history. Agricultural and advanced technology sector exports experienced particularly dramatic surges in 1995. Total exports of goods and services for 1995 exceeded $780 billion.

While the 1995 figures reveal that the U.S. trade deficit in goods and services increased by 4.5 percent in 1995 to $111 billion, this deficit in relation to the size of the U.S. economy is smaller than the deficits the U.S. experienced in the 1980's. In addition, due to the increasing global demand for U.S. goods and services, the deficit actually decreased over the last 6 months of 1995. Moreover, the U.S. trade deficit with Japan declined by 7 percent in 1995, reaching its lowest point in 12 years. U.S. exports to Japan grew by 20 percent in 1995, totaling $64 billion.

As a result of the spectacular growth in exports in 1995, some 880,000 new U.S. jobs were created, bringing the total of U.S. jobs supported by exports to 12 million. Since 1992, 1.6 million new jobs have been created as a result of increased U.S. exports.

ECAT's 1993 study of the role of U.S. multinationals in the U.S. economy, "Mainstay II," documents the positive contributions made by such firms to the U.S. balance of payments throughout the 1980's and into the 1990's. The study notes further that had it not been for the success of the U.S. multinationals during the 1980's, the U.S. international economic position would have been far worse given the weaker performance of U.S. firms oriented primarily toward the domestic market. In particular, the ECAT study found that:

- American companies with overseas investments generated positive trade surpluses from 1984 through 1990 due to sharply rising U.S. exports in every industrial sector. U.S. exports accounted for nearly 90 percent of U.S. economic growth between 1989 and 1991. U.S. multinationals accounted for nearly two-thirds of U.S. manufactured exports during that time period.

- For 1992, the net return on the foreign investments of U.S. multinational companies was the most positive single element in the U.S. balance of payments surpluses to the United States. Furthermore, as U.S. multinationals continue to build their operations abroad to assure future returns, they do so by reinvesting overseas earnings and not through the export of funds from the United States.

- Overseas investments keep American companies competitive and the growth in their exports has generated increased employment for their U.S. workers. The total number of jobs created directly or indirectly by the manufactured exports of U.S. multinationals reached 5 million in 1990.

Overall, the study points to the fact that increasingly U.S. exports are a major source of strength in the U.S. economy and generate new jobs.

Not only does U.S. export growth produce jobs but, according to a recently released joint report by the National Association of Manufacturers (NAM) and the Institute for International Economics (IIE), jobs created by exporting firms provide compensation which is on average 10 percent higher than that provided by non-exporting firms. The study also concludes that exporting firms are more productive

and economically stable, and add jobs at a rate 20 percent faster than non-exporting firms.

The joint NAM-IIE report like the ECAT study, also contradicts the myth that U.S. direct foreign investment leads to a decline in U.S. exports and is harmful to the U.S. economy. The study compared the export sales of the top 50 U.S. exporting firms which include many ECAT members, from 1984 to 1994, and concluded that whatever overseas investments these firms were making, they were not at the expense of their U.S. exports and that in fact foreign investment and exports mutually reinforce each other. The study notes in particular that even in sectors such as computer and aerospace which have large overseas investments, export sales are not decreasing.

Rather than losing in global competition, the trade statistics reveal that the United States is winning. While the weak U.S. dollar has clearly given U.S. exporters a competitive edge, that alone does not explain the positive trends nor does it guarantee that such trends will continue. Clearly, a strong set of multilateral trading rules, significant tariff reduction, and the elimination of non-tariff trade barriers have played a large role in producing positive results for the U.S. economy.

III. Agenda for the December Ministerial Meeting

In order to promote the operation of the WTO as a permanent institution, the WTO agreement requires that a Ministerial conference be held at least every two years, comprised of representatives of all member countries. The first Ministerial which will be held this December in Singapore will be viewed as an initial test of the effectiveness of the WTO as an institution. ECAT believes that it is in the U.S. interest to have the first Ministerial be viewed as a success.

In that spirit, ECAT believes that the agenda of the first meeting should emphasize those areas which will lead to expanded trade and investment and downplay those areas in which there is a lack of international consensus. With this overall recommendation in mind, the following paragraphs provide our views on the three major subject areas likely to be included in the agenda: (1) the implementation of existing agreements; (2) unfinished negotiations; and (3) new issues.

ECAT also believes that in light of the importance of securing China's accession to the WTO on the basis of a commercially acceptable protocol, this issue should be included on the Ministerial agenda as well.

A. Implementation Issues

ECAT believes that implementation issues should be foremost on the Ministerial agenda and that the WTO should hold itself and its members to the highest possible standard of implementation and compliance with WTO obligations. In particular, ECAT believes that the review of the implementation of the Trade Related Aspects of the Intellectual Property Rights (TRIPS) agreement should be given a high priority. In addition, ECAT believes that every effort should be made to accelerate the assumption of TRIPS obligations by developing countries. ECAT opposed the 5 year transition period that was granted to developing countries in the TRIPS negotiation. The United States should use the opportunity of the Ministerial Agenda to attempt to shorten the transition period.

Another important item under implementation should be the effort to accelerate the implementation of tariff cuts agreed to in Uruguay Round schedules. Some WTO member countries have already pledged to accelerate their cuts as part of the "downpayments" being made in the Asia Pacific Economic Forum (APEC) discussions. These commitments should be used as inducements to obtain similar pledges from other WTO members.

B. Completion of Unfinished Negotiations

The so-called unfinished business of the Uruguay Round includes the conclusion of negotiations on financial services, basic telecommunications, maritime services, the movement of people across national borders, steel, and aircraft. ECAT believes that the market access negotiations initiated during the Uruguay Round should also be included in this list.

ECAT has the greatest interest in the negotiations on financial services, telecommunications, and market access. Our views on these issues are discussed below.

1. Financial Services

The 76 WTO member countries who made commitments on financial services entered into an interim agreement which will come into force on August 1 of this year. Members will be allowed one year to ratify the agreement which will remain in effect until December 31, 1997. Negotiations to achieve further liberalization under a final agreement are expected to formally resume by the end of 1997.

At the end of June 1995, the United States announced that it found the offers made by other WTO members participating in the financial services sector negotiations to be unsatisfactory and that it intended to take an exemption from MFN treatment for all new investment in the U.S. financial services sector, including banking, securities, and insurance. The U.S. was particularly concerned by the lack of national treatment in the commitments by Korea, India, Indonesia, and Malaysia which would adversely affect U.S. banking, insurance, and securities firms.

ECAT believes that the United States has appropriately withheld MFN treatment in order to maximize its leverage in ongoing negotiations. ECAT is of the view that the United States should continue its efforts to improve market access commitments in the financial services sector.

2. Telecommunications

The Negotiating Group on Basic Telecommunications (NGBT) was established in April 1994 with the objective of securing progressive liberalization of trade in telecommunications transport networks and services within the framework of the General Agreement on Trade in Services (GATS). The NGBT negotiations are to be completed by April of this year. As in the other services sectors, the United States has appropriately reserved the right to take an MFN exemption for basic telecommunications services if it is dissatisfied with the liberalization offers and level of participation.

The United States maintains one of the world's most open and competitive markets in basic telecommunications services. The U.S. objective in the NGBT negotiations is to obtain commitments from other WTO members to make their markets as open to investment and competition as the U.S. market. Specifically, the United States has requested open-ended access for local, long-distance, and international services with no restrictions on foreign investment or technological or ownership configuration of networks. The United States has also sought commitments on regulatory reforms, including competition safeguards, transparency, and the independence of regulators from operators.

ECAT supports U.S. efforts to seek greater liberalization in telecommunications markets. However, it also believes that the U.S. government should stand firm as to both quantity and quality of offers so that a preponderance of WTO members joins the agreement, including emerging market countries.

3. Market Access

Another area which the United States wants to include in the Ministerial agenda is market access. During the Uruguay Round, the United States pursued the reciprocal elimination of duties among its major trade partners on a wide range of sectors. The United States was unsuccessful in achieving zero for zero tariff commitments in some of the sectors such as wood products, electronics, certain distilled spirits, and non-ferrous metals. The United States has continued to pursue zero for zero tariff commitments in these sectors. The United States has also been pursuing acceleration of tariff reductions agreed to in the Uruguay Round on items such as paper and broader commitments on the harmonization of tariffs on chemical products.

Even in the absence of new fast track negotiating authority, the Administration can enter into negotiations on these and some other product areas under the President's existing residual tariff-cutting authority. ECAT fully supports the Administration's efforts to continue market access negotiations within the WTO and believes that such negotiations should be included on the Ministerial Agenda.

C. Treatment of New Issues

In the interests of promoting greater support for the WTO, ECAT is of the view that the Ministerial agenda should place the greatest focus on those "new issues" which have the best prospects for achieving some consensus within the WTO. The discussion of those issues which lack any international consensus should be downplayed in the agenda as they are unlikely to produce any positive results. Similarly, issues which are the subject of negotiations in other fora and on which no consensus has been finalized are also not appropriate items for the agenda. With this in mind, the following paragraphs outline ECAT's views on the major "new issues" which have been advocated for the inclusion on the Ministerial agenda.

1. Labor

What is clear on the labor issue is that there is no consensus on the topic on any level. There has been no definition of what the labor issue is and what aspects of the issue are properly related to trade. The vagueness of the labor issue itself as it is being discussed reflects the absence of any broad-based international agreements on labor. The International Labor Organization (ILO) Conventions themselves do not represent as yet an international consensus as many WTO members, including the United States, have not signed all the ILO protocols. Finally, there is wide disagreement among WTO member countries, particularly between the developing and developed countries, over whether the issue is ripe for discussion within the WTO. In light of this wide disparity and lack of clearly established international standards, even a working party seems premature.

Because of the lack of international consensus on the labor rights issue itself and the wide dissension among WTO member countries over its inclusion within the WTO agenda, the placing of the labor issue on the Ministerial agenda is premature. ECAT believes that the United States should instead focus its efforts on labor issues within more appropriate alternative fora such as the ILO.

2. Environment

In October of 1995, the WTO Committee on Trade and Environment (CTE) agreed on a work program to review international trade and environment measures to determine whether WTO rules needed to be modified. One of the major issues being addressed within the CTE that is of concern to a number of ECAT companies is eco-labeling. Eco-labels or seals are generally symbols approved by certification panels based on their judgment as to the environmental effects of product manufacturing processes or packaging and are intended to promote products or

packaging which the panels deem to be good for the environment. Eco-labels are controversial because they are often not based on scientific evidence, stifle innovation and can operate as significant trade barriers.

U.S. industry has urged the U.S. government to oppose eco-labeling schemes within the CTE. Instead, U.S. industry advocates a market-oriented environmental information sharing system based on the Federal Trade Commission's Guide for the Use of Environmental Marketing Claims. ECAT endorses this view and believes that the United States should oppose eco-labeling schemes and support the adoption of voluntary environmental information sharing guidelines.

3. Competition

Canada and the EU have advocated the inclusion of competition policy on the Ministerial agenda. The United States has not advocated the discussion of competition policy and is now in the process of formulating its position on the issue.

Just as is the case with the labor issue, there have been no specific proposals to date as to how to define the competition issue and there is no consensus that it should be raised within the WTO. The current discussions on competition policy within the Organization for Economic Cooperation and Development (OECD) are preliminary and have yet to produce any guidelines.

In light of the absence of any clear definition of the scope of the competition issues to be discussed within the WTO, and the fact that the preliminary OECD discussions have not produced any concrete results, ECAT believes that the discussion of competition policy should remain within the OECD and that the inclusion of competition issues on the Ministerial agenda is premature.

4. Investment

The EU wants the WTO to discuss the rules on investment being developed within the OECD. The United States has taken the opposing view, arguing that the OECD negotiations on investment should be competed before they are discussed within the WTO.

The OECD rules being negotiated under the Multilateral Agreement on Investment (MAI) are intended to provide the highest possible set of standards which can be used as the basis for a broader WTO agreement. The concern is that if the OECD investment negotiations are discussed within the WTO before they have been completed, the investment standards under consideration might be diluted. Current WTO agreements containing investment-related provisions such as the General Agreement on Trade in Services (GATS) and the Trade Related Investment Measures (TRIMS) Agreement contain relatively low standards. Therefore, it is unlikely that WTO member countries would agree to any investment standards which were higher than those currently contained in WTO agreements. Thus, it is important to ensure that the high standards currently being discussed in the OECD go forward without being jeopardized by tangential WTO discussions.

ECAT therefore believes that any discussion of investment within the WTO should be limited and not interfere with or undermine in any way the discussion of the OECD investment rules under the MAI negotiations.

5. Standards

WTO Director General Ruggiero has suggested that standards issues be included in the Ministerial agenda. The United States has supported the discussion of standards cooperation issues. Meaningful progress may be achieved on standards issues in areas such as the encouragement of Mutual Recognition Agreements (MRAs) on product standards and testing. For example, within the Transatlantic Marketplace discussions, the United States and the EU have been able to make

significant progress in negotiating MRAs on telecommunications and certain other products, and have begun work on improving cooperation on auto safety and environmental standards. Progress has also been made on improving cooperation in the standards area within APEC.

ECAT fully supports the inclusion of a discussion of standards cooperation in the Ministerial agenda and the effort to expand the use of MRAs among WTO member countries. The U.S. auto, pharmaceutical, toy, and food product sectors, among others, could reap major benefits from global standards cooperation. This type of progress can be particularly effective as a form of trade liberalization "downpayment" which will demonstrate the WTO's effectiveness and promote its ability to facilitate future liberalization efforts.

6. Information Technology Agreement

The Information Technology Agreement (ITA) currently being negotiated between the United States and the European Union would provide for the elimination by the year 2000 of all ITA member country tariffs on information technology products on an MFN basis. The goal of the ITA is to provide services under the global information infrastructure at the lowest possible cost. It is hoped that ITA can be broadened to reach not only the quad countries, including Japan and Canada, but the APEC countries, Latin America, and other regions of the world.

ECAT believes that this issue should be included on the Ministerial agenda as a new area in which it may be possible eventually to achieve a broad international consensus. The negotiation of an ITA, especially one with wide membership, would benefit ECAT companies and the U.S. economy.

7. Bribery

The United States has said that it wants "corruption in trade" to be discussed at the Ministerial meeting as one of the most significant remaining non-tariff trade barriers. Ambassador Kantor has proposed that the discussions be initiated within the WTO on corruption in trade and that proposals for greater transparency requirements under the Government Procurement Code should be considered. ECAT also believes that the United States should work for greater transparency in the processes of the multilateral lending institutions such as the World Bank.

8. China's Accession to the WTO

In light of the critical economic and political importance of China in terms of bilateral relations and the multilateral trading system, it is essential to secure China's commitment to submit itself to WTO disciplines. ECAT believes that China's accession should also be included as an item on the Ministerial agenda.

China's accession to the WTO offers a unique opportunity to restructure U.S.-China trade in a direction that leads to a more stable and prosperous commercial relationship. However, China's accession to the WTO must be based on a commercially acceptable protocol that improves U.S. market access and implements WTO rules and obligations.

At the end of 1995, the United States presented the Chinese government with a "road map" outlining the commitments on market access, intellectual property, government procurement, services, and trade remedies that China would need to make in order for the United States to support China's WTO accession. The road map would allow China some flexibility to phase in its WTO obligations over time.

The Chinese government is very interested in obtaining WTO membership and has announced certain market access concessions including 30 percent tariff

reductions on 4,000 items in order to further its accession efforts. However, until the details of the concessions are published, their significance cannot be realistically evaluated.

ECAT believes that the inclusion of China's WTO accession as an item on the Ministerial agenda will promote greater progress on accession negotiations. ECAT believes that it is important that China be made to understand that it must agree to a commercially acceptable protocol of accession which includes:

- A substantial reduction and binding of tariffs on 2,300 priority items identified by the United States and a commitment to phase out residual quotas and import licensing restrictions.

- National treatment with respect to the treatment of foreign goods, services, and investment. In this regard, a commitment should be obtained to phase out import substitution and local content requirements, and to eliminate discriminatory taxes and restrictions on trading rights. With regard to trading rights, the United States should refuse to accept an extended phase-out period.

- The full implementation of the U.S.-China bilateral intellectual property rights agreements of 1992 and 1995.

- The elimination of restrictions on investment such as the imposition of requirements regarding export performance, import substitution, exchange rate balancing, and technology transfer.

- The provision of non-discriminatory market access and the liberalization of existing geographic and licensing limitations to U.S. service providers, including financial services and telecommunications.

- The modification of industrial policies which are inconsistent with the WTO.

- The elimination of barriers to U.S. agricultural exports which are inconsistent with the WTO, including phytosanitary measures that operate as disguised restrictions on trade.

Of these elements, ECAT member companies are particularly concerned with gaining significant commitments on market access, trading rights, services, and investment.

IV. Extension of Fast Track Negotiating Authority

The agenda set out above can for the most part be achieved without new fast track negotiating authority. However, if the United States is to maintain its leadership role in supporting the WTO and pressing for its expansion, the President's fast track negotiating authority must be extended. As it has testified in the past, ECAT believes that the extension should be multi-year and unencumbered by non-trade-related provisions on labor and environment.

ECAT hopes that a bipartisan effort can be re-initiated to secure extension of fast track authority. ECAT urges Subcommittee members to revisit the issue.

V. Conclusion

ECAT believes that the United States must maintain its leadership role in supporting the WTO and in pushing for its continued expansion. In order to do this, the importance of the WTO to the global trade regime and the benefits of that system to the U.S. economy must be widely proclaimed. Critics of the system must be reminded as well that the very system that they claim is encroaching on U.S. sovereignty and draining U.S. jobs, is the system that the United States itself has

toiled over the last 50 years to create in order to best protect its economic interests. Despite any negative rhetoric, the system has worked to promote U.S. economic interests, has enabled U.S. exports to surge in world markets and has created better, higher-paying jobs for Americans.

As we look forward to the first WTO Ministerial in December, ECAT believes that the United States should bolster the credibility of the WTO by promoting an agenda which focuses on implementation, the completion of unfinished negotiations, and those new issues on which there is some international consensus and promise of eventual agreement.

Finally, we would hope that efforts could be made to reach an agreement on the extension of the President's fast track negotiating authority, thereby promoting the continued expansion of the multilateral trading system.

STATEMENT OF D. GEORGE HARRIS,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER,
HARRIS CHEMICAL GROUP, INC. AND
HARRIS SPECIALTY CHEMICAL, INC.

This statement for the record is being submitted in connection with the March 13, 1996, Hearing on Implementation of the Uruguay Round Agreements and the WTO held by the Subcommittee on Trade of the Committee on Ways and Means of the U.S. House of Representatives.

The statement is submitted by D. George Harris, Chairman and Chief Executive Officer of Harris Chemical Group, Inc., a holding company for a group of inorganic chemical and extractive mineral businesses. The company's North American operations are comprised of North American Salt Company, North America's third largest salt producer with production facilities in Hutchinson and Lyons, Kansas, and Cote Blanche, Louisiana; North American Chemical Company, a major producer of soda ash, boron chemicals, sodium sulphate and sodium bicarbonate, with production facilities in Searles Valley, California; and Great Salt Lake Minerals, North America's largest producer of sulfate of potash, with production facilities on the Great Salt Lake in Ogden, Utah. I am also Chairman and Chief Executive Officer of Harris Specialty Chemicals, Inc., headquartered in Jacksonville, Florida, which is a producer of specialty formulated chemicals for the construction, silicone, pharmaceutical and plastics industries, with production facilities in California, Florida, Georgia, Indiana, New York, Pennsylvania and Texas.

As a chemical company CEO, my attention focuses principally on market access, customs procedures and investment. I leave specific comments on other areas to those with more tangible connections.

The WTO should remain the cornerstone of U.S. trade policy

Let me start with a general comment. I believe that trade and investment liberalization and worldwide reduction in trade and investment barriers are in the overall economic interests of the United States. President Clinton was on target when he declared that we must compete, not retreat. Starting from this premise, I believe that securing universal implementation of the commitments and obligations undertaken in the Uruguay Round, and striving to broaden and deepen those commitments and obligations, should remain the cornerstone of U.S. trade policy. This does not preclude regional or bilateral initiatives, but they should be fully consistent with the WTO.

Importance of U.S. Enforcement Efforts

The Uruguay Round greatly reduced tariff and non-tariff trade barriers and set improved new rules in many areas. However, trade agreements are merely pieces of paper; what counts is implementation of the commitments and obligations contained in them. For this reason, I wholeheartedly support the creation of offices within USTR and the Department of Commerce which will be responsible for monitoring compliance by our trading partners with their WTO commitments and obligations and for coordinating enforcement action against those who do not honor those commitments and obligations. These offices bear a heavy responsibility, for the WTO will remain credible only if it is fully implemented by all signatories. For them to be able to do their job properly, this Subcommittee and other relevant committees of jurisdiction must ensure that adequate resources continue to be made available.

Focus on Implementation at the Singapore Ministerial

In December the trade ministers of all WTO members will meet in Singapore for the first of the biennial meetings at ministerial level mandated by the WTO Agreement. The President's Advisory Committee on Trade Policy and Negotiations, of which I have the honor to be a member, recently submitted a report on WTO implementation to the United States Trade Representative. In the Report the ACTPN recommended that the U.S. Government should make maximum efforts to ensure that the Singapore Ministerial fully and frankly assesses the implementation records of all WTO members and spurs all members both to meet existing obligations and to take all steps necessary to meet future obligations by the date specified for them to do so. The ACTPN report also recommended that the United States urge the other WTO members to make a political commitment to improve upon and to accelerate full implementation of the WTO agreements.

I supported these recommendations as a member of the ACTPN and I support them as a chemical company CEO. Now is not the time to try to launch major new trade initiatives in areas where widely divergent views still are held. Rather, it is the time to consolidate the major advances of the Uruguay Round, to put into practice the promised liberalization of the WTO Agreements.

Secure Additional Tariff Cuts

I believe that the United States Government also should work hard to convince the other WTO members to reach agreement on additional market access commitments. Additional tariff cuts and tariff harmonization in the chemicals sector would be of immense value to my companies and all other companies in this vibrant and important sector of our economy.

Accelerated staging of tariff cuts also is very important. One example, very important to me, is soda ash. It is one of the major products of North American Chemical, one of my companies. Accelerated staging of tariff cuts would provide significant opportunities for additional soda ash exports.

The United States Government has residual "fast track" authority to implement the results of additional tariff reductions and accelerated staging in chemicals. Finishing the unfinished business of the Uruguay Round, then, not only is economically important to companies like mine; it is already authorized by the Congress.

Working for an Agreement on Investment

Looking beyond the near term, where I believe U.S. efforts should be devoted to consolidating the advances of the Uruguay Round, I consider conclusion of a strong international agreement on investment to be the top priority. My companies are dynamic and our horizon is global. I always am on the lookout for attractive opportunities around the world. For companies like mine, a strong, comprehensive investment agreement that would significantly reduce the risks and uncertainty of foreign investment is of great interest. Good work is underway in the OECD in Paris to reach agreement on a Multilateral Agreement on Investment. That work should be concluded, in my opinion, before any substantive discussion starts in the WTO. Otherwise, I fear a weak, and consequently valueless, agreement would result. I urge this Subcommittee to become more actively involved in oversight of the OECD investment discussions, supporting the goal of completing a strong, comprehensive multilateral investment agreement.

Need for Fast Track Authority

I cannot conclude without adding my voice to those who urge Congress and the Administration to resolve their differences so that Fast Track authority will be renewed as soon as possible. U.S. leadership in the WTO, U.S. credibility in ongoing regional initiatives, and the economic health of this country are all jeopardized by the ongoing impasse.

I thank the Subcommittee for this opportunity to provide my written views on the linch pin of our international trade policy -- the WTO.

By Permission of the Chairman.

THE WORLD TRADE ORGANIZATION: A JAMAICAN PERSPECTIVE

STATEMENT OF
DR. RICHARD L. BERNAL
AMBASSADOR FROM JAMAICA TO THE UNITED STATES
SUBMITTED TO THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON TRADE

IN RESPONSE TO ITS REQUEST FOR COMMENTS ON THE WORLD TRADE ORGANIZATION (WTO)

MARCH 29, 1996

Thank you for providing me this opportunity to submit testimony to you on the World Trade Organization (WTO) and its impact on Jamaica's trade relationships.

The World Trade Organization (WTO) plays a vital role in providing the framework for a healthy and functioning multilateral trading system, both to establish ground rules for fair commerce and to create a process for future rounds of trade negotiations. From its origins in the General Agreement on Tariffs and Trade (GATT), which was inaugurated in the late 1940s, the WTO has emerged to encompass the trading relations of some 140 nations, representing nearly all international commerce. During that time, international trade flows have flourished as nations and products have been brought under the umbrella of the multilateral trading regime. With the conclusion of the Uruguay Round in 1993, and the entry into force of the WTO on January 1, 1995, the multilateral trading system expanded again as GATT/WTO members removed barriers and brought about new disciplines in previously uncovered areas, such as services, intellectual property, agriculture, and investment.

Jamaica's Commitment to Trade Liberalization

Jamaica is deeply committed to an open multilateral trading system.. Jamaica subscribes to, and its policy has always been fully consistent with, the principles and disciplines of the GATT. Jamaica has been a Contracting Party to the GATT since the 1960s, and has been an active participant in, and contributor to, successive negotiating rounds aimed at further liberalization of global trade. In 1995, Jamaica was proud to ratify its obligations under the Uruguay Round and become a founding member of the WTO.

Moreover, Jamaica is an advocate of trade liberalization within the hemisphere, and is currently serving as Chair of the Small Economies Working Group for the Free Trade Area of the Americas. In addition, Jamaica actively participates in several regional trade expansion arrangements with the United States (the Caribbean Basin Initiative -- CBI), Europe (the LOME Convention), Canada (CARIBCAN), and the other English speaking countries in the Caribbean (the Caribbean Common Market - CARICOM). All of these arrangements are intended to promote trade liberalization between the member countries.

Jamaica's support for the multilateral trading system is grounded in the firm belief that there is now a new phase of globalization of production and finance which is rapidly sweeping away national barriers to the movement of goods, services, capital, and finance. During the late 1980's and 1990's, Jamaica's economic policies have focused on economic reform, stabilization, and structural adjustment to create an environment conducive to a private sector-led, market-driven, outward-looking growth strategy. An important aspect has been a comprehensive program of trade liberalization involving substantially reduced tariffs and the elimination of quantitative trade restrictions. This has

been complemented by freeing market forces within the domestic economy through the abolition of price and exchange controls by a vigorously implemented campaign of privatization and fiscal and monetary discipline.

In the last four years there has been a substantial acceleration in the process of liberalising the trade regime of Jamaica, with an emphasis on the removal of import restrictions and the lowering of tariffs. The commitment to outward-looking trade and development policies stems from the knowledge that the benefits to be derived are those of higher growth rates and enhanced capacity to adjust to external shocks. Expanding trade contributes to Jamaica's growth by enabling the economy to improve its productivity by specializing in exports in which it has a comparative advantage. Production for the world market allows firms to achieve the economies of scale which are precluded by a small domestic market. Exposure to competition from imports serves to improve cost efficiency and benefits consumers by lower prices.

Since the process is self-driven -- more competitive products leads to broader trade relationships which, in turn, stimulate the demand for even more competitive products -- Jamaica's economy has become tightly woven into the fabric of international commerce. The WTO ensures that the fabric does not tear, or, if it does, that there be an obvious and quick way to repair it.

The US/Caribbean Linkage: A Regional Example of Successful Trade Liberalization

On a regional scale, such reciprocal trade liberalization has provided the foundation for sustained development of the Caribbean economies and a healthy US/Caribbean economic relationship. In August 1995, the Caribbean Basin Initiative (CBI) marked its 12th anniversary. In the dozen years since it was established, the CBI has emerged as an important stimulus of economic development in the Caribbean Basin and of trade linkages throughout the region. The effect has been felt -- not only in Kingston and Montego Bay -- but also in Miami, Baltimore, New Orleans, New York, and hundreds of other communities throughout the United States. In many ways, the CBI has exceeded the expectations of the drafters of the CBI legislation who wrote in 1990 amendment to the CBI, "The Congress finds that...a stable political and economic climate in the Caribbean region is necessary for the development of the countries in the region and for the security and economic interests of the United States. [1]

Through its combination of trade, investment, and tax policies, the CBI legislation has progressively established a framework that has allowed mutually beneficial US/Caribbean economic links to flourish. In turn, Jamaica and other Caribbean countries have matched the liberalizing reforms enacted by the CBI to launch their own trade and investment economic reform programs. Together, the United States and Caribbean countries have created a trade partnership that now exceeds $24 billion a year.

The successes of the CBI legislation are reflected in the figures signaling robust growth in the US/Caribbean trade partnership. Since the mid-1980's, US overall exports to the Caribbean have expanded by over 100 percent and Caribbean exports to the United States have climbed by roughly 50 percent. The Caribbean Basin now comprises the tenth largest market for the United States, and is one of the few regions where the United States consistently posts a trade surplus.

With US exports exceeding $13.4 billion in 1994, US/Caribbean commercial links support more than 265,000 jobs in the United States. During the past decade, nearly 17,000 American jobs have been created each year as US trade links with the Caribbean have expanded. Throughout the Caribbean, where the economies are much more dependent upon trade, increased exports to the

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[1] Section 201 of the Caribbean Basin Economic Recovery Expansion Act of 1990. Codified at [19 USC 2701nt; PL 101-382; Title II]

United States has generated hundreds of thousands of additional jobs. Such employment growth has been felt in both export industries, as well as in the many sectors that cater to these industries.

Such trade and employment growth reveals a fundamental characteristic of US/Caribbean production cycles. The existence of CBI market access agreements, combined with the proximity and skills of the Caribbean workforce, has made Caribbean production an attractive and profitable element of any US production strategy. For example, through offshore assembly agreements, the Jamaican private sector has developed an active partnership with US industry to take advantage of the most efficient productive activities that each country offers. In a host of industries, US and Jamaican firms cooperate to produce finished goods using a combination of Jamaican and American skills, capital, and technology. It is this complementarity of Jamaican/US production that maintains the competitiveness of the final product in the global marketplace and even in the US market.

The new structure of trade means that economic growth and development in the Caribbean now directly translate into expanded export opportunities for the United States. Roughly 70 cents of each dollar Jamaica earns from exports to your country is spent in the United States buying American-made consumer goods, food products, industry inputs, and capital equipment. When compared with each dollar of Asian imports, which only generates about 10 cents worth of subsequent US purchases, trade with the Caribbean becomes an important priority for the United States.

Moreover, by providing a mechanism to enhance US/Caribbean commercial links, the CBI has created a sound basis for cooperation in other areas, such as environmental protection, counter-narcotics activities, the promotion of democracy, and regional security measures.

WTO: The Next Steps

As the trade ministers, gather in Singapore this year for the first WTO ministerial, the global trade community should establish a firm agenda to assess the first two year's of the WTO and to determine the next steps that must be taken to strengthen and expand the system.

As a first agenda item, ***trade ministers should determine how well countries are living up to their WTO obligations.*** Care should be taken to ensure that countries have not only implemented their initial obligations, but that all phase-in periods are fully respected. In addition, WTO member countries should be made accountable to their obligations to ensure that, among other things, they do not subsequently pass legislation that undermines those obligations. For example, recent efforts by the United States to embargo specific countries -- such as Cuba, Iran, and Libya -- by imposing extraterritorial sanctions on third-party foreign companies and countries, raise a series of questions as to whether such unilateral sanctions are fully consistent with the WTO principles.

A related agenda item is to ***determine how well the Dispute Settlement Process is working.*** Based on the number and kind of trade disputes that have been brought for resolution under the various WTO dispute settlement mechanisms, it would appear that the WTO had gained the reputation as a credible venue for the airing of trade-related conflicts. One would hope that the WTO can maintain a pre-eminent role in this regard so that countries do not feel compelled to resolve disputes -- such as the US/EU dispute on bananas -- through unilateral actions, such as the US Section 301 law.

A third priority area involves ***completing the unfinished business of the Uruguay Round and identifying new areas that must be addressed in successive rounds.*** The Uruguay Round has triggered an unprecedented surge of action as individual nations, regions, and multilateral bodies race to dismantle barriers and liberalize trading regimes. The WTO can play a role, not only in sustaining this momentum, but also in coordinating the diverse liberalization responses it has unleashed. At the very least, it should ensure

that trade liberalization -- whether done regionally, multilaterally, or bilaterally -- is fully consistent with the WTO principles.

The WTO and the United States

As the Congress reviews the WTO, it should recall that -- as a collection of diverse trading nations -- the WTO will work only as well as its members want it to work. If enough individual nations refuse to play by its rules, the WTO system will collapse. ***As one of the largest trading entities in the WTO, the United States enjoys a particularly critical role in actively participating in the WTO to ensure its successful operation.*** And because so much of the US economy is becoming dependent upon international trade and foreign markets, the United States has a greater and greater stake in the success of the WTO.

The Congress can play a vital part in ensuring vibrant US participation. First, Congress can provide the President fast track trade negotiating authority to permit the negotiation of future rounds as well as the negotiation of other trade liberalization agreements, such as accession to the NAFTA. Second, the Congress can take a leadership role in promoting an active trade agenda through passage of such measures as the NAFTA parity bill or the renewal of the GSP program. Third, the Congress can resist efforts to alter or limit US obligations under, or membership with., the WTO.

Conclusion

The World Trade Organization works. It is now up to the individual members of the WTO to keep it that way.

NAM National Association of Manufacturers

Howard Lewis III
Vice President
Trade and Technology Policy

March 15, 1996

The Honorable Philip M. Crane
Chairman
Subcommittee on Trade
Ways & Means Committee
U.S. House of Representatives
1104 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Because of illness, I unfortunately was not able to testify in the Subcommittee hearings held on March 13 which dealt with the implementation of the GATT/WTO. I would like to submit the statement I had prepared and ask that it be included in the hearing record.

In this statement, there is extensive reference to a new report on U.S. exports, *Why Exports Matter: More!* This was just published by the Institute for International Economics and The Manufacturing Institute, an educational and research affiliate of the NAM. I have enclosed a copy for your review.

The report shows that exports really do matter more than most people think. In terms of pay, productivity and performance, exporters do substantially better than non-exporters. The most startling area in which they do better, however, is job growth. Since the late 1980s, exporters experienced almost 20 percent faster employment growth than non-exporters.

The real question we should be asking is how does this country get more of this? The answer lies in opening up market opportunities through multilateral trade agreements such as the GATT/WTO. You are to be congratulated for focusing on this fact in your March 13 hearings.

Sincerely,

The report is being held in the Committee's files.

STATEMENT OF

HOWARD LEWIS III
VICE PRESIDENT FOR TRADE AND TECHNOLOGY POLICY
NATIONAL ASSOCIATION OF MANUFACTURERS

ON
IMPLEMENTATION OF THE GATT/WTO

BEFORE THE
TRADE SUBCOMMITTEE
OF THE
WAYS AND MEANS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

MARCH 13, 1996

Mr. Chairman, my name is Howard Lewis. I am vice president for trade and technology policy at the National Association of Manufacturers (NAM).

I am here today to testify on the implementation of the GATT/WTO agreement. In addition to specific comments on the actual implementation of this agreement, I would like to reiterate why the United States benefits from, and must continue to support, a strong multilateral trading system as embodied by the GATT/WTO.

If this subcommittee takes no other message away from my testimony today, it is that the NAM strongly supports the multilateral trade system represented by the GATT/WTO. Two years ago before this subcommittee, I testified that "the NAM believes that the Uruguay Round Agreement...is clearly in the interests of American manufacturers. We strongly support it..."

This is why a year ago the NAM and other U.S. business groups met with our counterparts from Europe and Japan to discuss the future of the GATT/WTO. The fact that these business groups got together for a meeting was probably as significant as any of the specific policy issues raised. The meeting underlined the importance that American, European and Japanese businesses attach to a properly functioning multilateral trade system.

In terms of immediate action, the business groups participating in this meeting wanted to see —

- quick and effective implementation of the WTO dispute settlement body;
- completion of negotiations in the areas of financial services and telecommunications;
- action on China's accession to the WTO; and
- a multilateral agreement on investment at the OECD.

In addition, the American, European and Japanese business groups welcomed the establishment of the WTO Trade and Environment Committee. They went on to state, however, that unilateral trade measures were not appropriate to achieve environmental objectives outside the jurisdiction of the importing country. Transboundary or global environmental problems should be addressed through multilateral environmental agreements.

I have gone over this list because almost all of these issues are still with us today. Negotiations over financial services and telecommunications are still going on. The terms for China's accession to the GATT/WTO have not been worked out. A multilateral

agreement on investment is within reach by mid-1997 establishing high standards of investor protection. Finally, the subject of trade and the environment is still hotly debated.

All of these issues are important to the implementation of the GATT/WTO. In addition, there are a number of "new" issues such as competition policy, bribery and corruption, and the enlargement of the government procurement agreement. Each one could take up an entire hearing by itself. So, rather than go into detailed discussion about any of them, I want to step back from the proverbial trees and take a look at the entire forest and try to answer a very simple question.

The question is this: What does the U.S. have at stake in the multilateral trading system?

In giving you the NAM's answer, I want to draw your attention to some groundbreaking work that has been done at the Institute for International Economics (IIE) with the support of The Manufacturing Institute, the educational and research affiliate of the NAM. This work has been going on for the past year and a half and provides new insights into the importance of trade to the U.S. economy. Two reports have been produced, *Why Exports Really Matter!* (1995) and *Why Exports Matter: More!* (1996).

The idea behind our two reports is simple. While everyone agrees that exports are desirable and important, surprisingly little information is available on the actual performance and structure of export firms. Are exporting firms different from non-exporting firms and, if so, where do these differences show up? In worker pay? Benefits? Productivity? Job growth? Survival rates?

The basic message in the two reports is that exporting matters to the average American worker and average American company far more than most people realize. There are distinct differences between exporters and non-exporters in terms of pay, productivity and performance:

- Pay in export plants is on average 15 percent better.
- Benefit levels are 37 percent higher.
- Productivity is 40 percent greater.
- Exporting improves company survival rates by 10 percent.
- Job growth is 17-18 percent greater.

A lot more lies behind each of these numbers than I can cover in this testimony, but I would like to zero in on the job growth numbers for a minute.

The data on job growth were among the biggest surprises to come out of our work. First, the magnitude of the difference was startling. For the period covered by the data, virtually all the decline in average employment was attributable to non-exporting plants. In contrast, the workforce at exporting plants grew by 17-18 percent.

Second, the role of small business in this employment growth was even more surprising. Small exporters had growth levels 1-2 percent higher than the average. If these growth rates were maintained by just one-third of small exporters, a million jobs a year would be generated.

Looking at just statistics, however, doesn't capture the essence of the two reports. For example, the benefits I have just noted in terms of wages, productivity and job growth seem to show up once a firm makes a commitment to exporting, not after it reaches a certain level (or intensity) of exporting. This was a surprise. Most people would assume just the opposite to be the case. Moreover, the data reveal that these benefits show up across the board in small companies as well as large. The benefits of exporting, in short, don't just go to the big multinational firms.

The latest report, *Why Exports Matter: More!*, also takes up the difficult issue of cause and effect. All of the benefits I have just been talking about are clearly associated with exports, but do exports cause any of them? The answer depends on which benefits you are talking about. In the case of wages and productivity, for example, the relationship seems to resemble some sort of "positive feedback loop." One thing reinforces the other so that good firms wind up exporting and exporting helps make good firms.

For job growth and corporate survival rates, however, the relationship seems to be more linear — one thing comes before the other. The evidence indicates that exporting leads to the improved job growth and survival rates cited a few minutes ago.

As stated earlier, I believe that our two reports make important, new contributions to our understanding of how trade makes an impact on the U.S. economy. I have tried to highlight some of the important finds from the reports, but have hardly done them justice. I hope that members of this subcommittee will review the two reports in more detail.

Before concluding, I would like to make one final point. In this era of TV soundbites of candidates standing in front of shuttered factories or sitting in brand-new cars on the assembly lines, it is sometimes difficult to tell if these anecdotal stories represent or distort what is really going on in our economy. Selective use of information is not a problem with the statistics I have just given you. They are based on data from the Census of Manufacturers. The data come as close as you can to the total universe of manufacturing plants and firms in this country. We aren't talking about anecdotal material, samples or surveys. We're talking about the total population of plants and firms in this country.

What all these data show are that exports really do matter. They matter in terms of higher job growth, better pay and benefits, greater productivity, and improved corporate stability. The question we all should be asking ourselves is: How do we get more of this? The answer is through supporting a properly multilateral system of trade that opens up opportunities for U.S. firms in the global marketplace.

Before the
Subcommittee on Trade
House Ways and Means Committee

STATEMENT OF THE NATIONAL PORK PRODUCERS COUNCIL REGARDING IMPLEMENTATION OF THE URUGUAY ROUND AGREEMENT

INTRODUCTION

On February 7, 1996, the Committee on Ways and Means, Subcommittee on Trade, provided notice that it was holding hearings on the implementation of the Uruguay Round Agreement. The subcommittee also invited the views of interested parties through submission of a written statement. The National Pork Producers Council (NPPC) hereby expresses its views regarding implementation of the Uruguay Round Agreement.

The National Pork Producers Council is a national association representing pork producers in 43 affiliated states who annually generate approximately $11 billion in farm gate sales, $66 billion in economic activity and employ 764,000 Americans from the farm through processing. NPPC is a nonprofit corporation incorporated in the State of Iowa.

The United States is the lowest cost producer of pork in the world. Danish producers, which are the lowest cost producers in the European Union and the leading global competitors of U.S. producers, have production costs that, on average, are 50 percent higher than the costs of U.S. producers. The production costs of Canadian producers are 10-15 percent higher than the costs of their U.S. counterparts while Mexican production costs are 60 percent higher than U.S. costs.

Pork is the world's meat of choice. Pork represents 44 percent of daily meat protein intake in the world. Beef is a distant second at 28 percent of daily global protein intake. U.S. pork producers were ardent proponents of NAFTA and the Uruguay Round Agreement. The industry strongly supports further trade liberalization measures. These trade agreements permit U.S. pork producers to exploit their comparative advantage in international markets.

THE PHILIPPINES IS BREACHING ITS URUGUAY ROUND COMMITMENTS ON PORK

Prior to the Uruguay Round Agreement, the Government of the Philippines, by virtue of Memorandum Order No. 95, prohibited imports of swine, pork and pork products unless a short supply situation was certified by the Secretary of Agriculture. In the Uruguay Round the Government of The Philippines (GOP) agreed to a tariff rate quota (TRQ) on pork of 32,520 metric tons (MT) beginning July 1, 1995, increasing to 54,210 MT by the end of the implementation period (2004/5).

Unfortunately, the benefits negotiated with respect to Philippine pork in the Uruguay Round have been illusory. The GOP is violating its commitment to implement its pork TRQ. This violation of the Uruguay Round Agreement deprives the U.S. of approximately $60 million annually in pork exports and will escalate as the full TRQ is phased in. This issue is particularly frustrating given The Philippines' leadership this year in the Asia Pacific Economic Cooperation forum.

Not long after execution of the Uruguay Round Agreement, the GOP notified the United States that it intended to reduce the TRQ to which it previously agreed upon. On October 24, 1994, the U.S. Government properly notified the GATT Secretariat and the GOP that it was unable to accept the Philippine proposal to reduce its Uruguay Round access commitments for pork from 54,210 MT to 6,003 MT.

The U.S. pork industry understands that the GOP may unilaterally impose restrictions on access for pork by modifying the TRQ to restrict access to 2,000 - 3,000 MT of pork cuts with the balance of approximately 30,000 MT limited to "chilled pork heads and feet." Such unilateral action by the GOP would effectively keep the Philippine market closed but for a paltry 3,000 MT. Pig heads and feet are particularly susceptible to spoilage and, for purposes of international trade, are shipped frozen. Air freight is not an option because heads and feet are low valued items. Further, the Philippine market likely could absorb only a small amount of heads and feet. The Philippines must not be permitted to restrict the type of pork imported under the TRQ or otherwise reduce its Uruguay Round commitments.

According to Philippine importers, the GOP will imminently apply a discriminatory "value added" tax on certain imports including pork and pork products. Domestic meat will be exempted from the tax. This additional and illegal trade barrier, which is nothing more than an attempt by the GOP to circumvent its Uruguay Round obligations, must not be tolerated.

Given the failure of the GOP to honor its Uruguay Round pork market access commitments, the U.S. pork industry requests that the U.S. Government take all appropriate measures, including a World Trade Organization case, to redress this egregious situation. The GOP should be required not only to comply with its Uruguay Round commitments but should also be required to pay compensation for delaying the implementation of its commitments. Anything less minimizes the importance of the Uruguay Round Agreement and sends a clear signal to our trading partners that the U.S. is not serious about enforcing trade agreements.

THE EUROPEAN UNION HAS FAILED TO IMPLEMENT ITS URUGUAY ROUND OBLIGATIONS AS THEY RELATE TO THE THIRD COUNTRY MEAT DIRECTIVE

The Third Country Meat Directive (TCMD) is a sanitary measure adopted by the European Union which requires each meat exporting facility located in countries outside the EU to be in compliance with detailed requirements as to facilities, equipment, veterinary staffing and procedures, structural materials, carcass washing, annual employee physical examinations, officially monitored vehicle washing and disinfecting stations, etc. The United States Department of Agriculture, Food Safety and Inspection Service administers U.S. sanitary measures. The TCMD requirements are more onerous than U.S. requirements and, importantly, do not result in meat that is any safer or more wholesome than meat produced and inspected in the United States. The Third Country Meat Directive is nothing more than a trade barrier.

The European Union is violating a 1992 meat agreement that was intended to open the EU market to U.S. pork and beef (non-hormone) by resolving the TCMD dispute. The agreement stemmed from a 1990 Section 301 petition the U.S. meat industry filed in response to the EU's ban on U.S. exports purportedly for failure to comply with the terms of the TCMD. The EU has not complied with the commitments made to the United States Trade Representative (USTR) in the 1992 agreement and U.S. pork exports remain almost completely locked out of the EU. Although the EU repeatedly expressed an interest in reaching a mutually satisfactory resolution of the dispute, its promises have amounted to nothing more than empty rhetoric.

The crux of the EU's violation is its failure to practice equivalence by recognizing that U.S. veterinary safety and inspection procedures are consistent with EU requirements. In spite of the EU's admission in the November 1992 exchange of letters "that both regulatory systems basically provide equivalent safeguards against public health risks," the EU subsequently has failed to implement the agreement.

Notwithstanding the 1992 bilateral meat agreement, the EU's failure to recognize equivalency in applying the TCMD is a clear repudiation by the EU of its Uruguay Round obligations. Specifically, as a signatory to the recently enacted Uruguay Round GATT Agreement, the EU agreed to be bound by the Agreement on Sanitary and Phytosanitary Measures (S&P Agreement). The EU's violation of the terms and principles contained in the Exchange of Letters constitutes a disregard for the GATT obligations embodied in the S&P Agreement.

Indeed, the principle of equivalency is one of the cornerstones of the S&P Agreement, requiring member countries to recognize equivalent practices in employing sanitary measures. Specifically, under Article 4 of the Agreement, members must:

> accept the sanitary or phytosanitary measures of other members as equivalent, even if these measures differ from their own or from those used by other Members trading in the same product, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member's appropriate level of sanitary and phytosanitary protection. . . .

S&P Agreement, Art. 4.1 (emphasis added). As explained above, EU requirements regarding facilities, equipment, veterinary staffing and procedures, structural materials, non-chlorinated carcass washing, direct inspector control of label inventories, special labels bearing the EU mark of inspection, annual employee physical examinations, and officially monitored vehicle washing and disinfection stations are duplicative of slightly different -- but equally safe -- U.S. requirements. In fact, the EU has offered no evidence indicating that U.S. facilities operating under USDA guidelines have failed to achieve the level of sanitary protection that the TCMD allegedly was established to achieve. Under these circumstances, the EU must recognize U.S. procedures as equivalent, and its failure to do so constitutes a breach of its GATT obligations.

Moreover, the EU's insistence that U.S. meat exports comply with the specific requirements of the TCMD where these requirements are not necessitated by science directly contradicts another of its most basic GATT obligations. Specifically, Article 2.2 of the S&P Agreement limits sanitary and phytosanitary measures to those measures that are "based on scientific principles" and precludes the application of any regulations that are "maintained without scientific evidence." The EU, however, has offered no scientific basis for insisting on compliance with the standards of the TCMD. This absence of scientific justification renders the TCMD inconsistent with the rules governing the establishment of standards for trade in agricultural products.

Finally, it is widely known that the large majority of EU pork plants do not meet TCMD requirements. According to USDA officials, internal reviews conducted by the EU demonstrate that in 1991, only three percent (3%) of the cutting and slaughter facilities approved for intra-EU trade fully complied with the standards of the TCMD. In the case of Spain, for example, 96 percent (96%) of Spanish abattoirs were unable to comply with the hygiene and technical requirements established by the TCMD, and as a result, have been forced to apply for a temporary derogation of EU rules. Holding U.S. facilities to a set of rules that the EU's own producers are

unable to comply with is clearly discriminatory, and thus violates the principles of national treatment applicable to trade in agriculture contained in Article 2.3 of the S&P Agreement. Clearly, the EU's application of the TCMD is in direct violation of its international trade obligations to the United States.

ARGENTINA, BRAZIL, SOUTH AFRICA AND VENEZUELA HAVE FAILED TO IMPLEMENT THEIR OBLIGATIONS UNDER THE S&P AGREEMENT

The Governments of Argentina, Brazil, South Africa and Venezuela are wrongfully denying U.S. producers the opportunity to export pork to their countries in contravention of their Uruguay Round commitments. Argentina and Brazil use Transmissible Gastroenteritis (TGE) as an excuse to close their markets to exports. However, transmission of TGE via pork and pork products has never been scientifically documented. Further, TGE is endemic to South America. (See Diseases of Swine, Straw [ed.])

Argentina, South Africa, and Venezuela use Porcine Reproductive and Respiratory Syndrome (PRRS) as an excuse to close their markets to exports. The use of PRRS constitutes a blatant trade restriction. The PRRS virus is endemic to the world. (This was substantiated at the Second International Symposium on PRRS held in August 1995 in Denmark.) PRRS has been identified in all countries that have tested for the virus. Testing in Argentina, South Africa, and Venezuela would reveal the virus within swine herds in each of those countries. Put differently, like other countries, these three countries cannot demonstrate scientifically that their swine are free of PRRS. Given that these countries do not regularly test their domestic swine for PRRS, these countries obviously have no real interest in monitoring the virus.

South Africa also uses pseudorabies virus (PRV) to restrict the entry of pork imports into its market. Like PRRS, the transmission of PRV to importing countries through incoming pork or pork products has not been scientifically documented. U.S. pork and pork products, regardless of whether produced in a PRV-free region of the United States, are imported into Canada, a PRV-free country. Further, extensive sampling of U.S. pork in conjunction with Russian concerns yielded only negative test results.

As previously indicated, Article 2.2 of the S&P Agreement limits sanitary and phytosanitary measures to those measures that are "based on scientific principles" and precludes the application of any regulations that are "maintained without scientific evidence." The four aforementioned countries, however, have offered no scientific basis for their various sanitary prohibitions. This absence of scientific justification for their actions is inconsistent with the rules governing the establishment of standards for trade in agricultural products.

These sanitary barriers to trade annually cost the U.S approximately $75 million in lost export revenue to Argentina, $37 million in lost export revenue to Brazil, $112 million in lost export revenue to South Africa, and $25 million in lost export revenue to Venezuela.

CONCLUSION

The U.S. pork industry strongly supported NAFTA and the Uruguay Round, and supports further trade liberalization. While U.S. pork exports are growing, pork exports would be significantly higher absent the unfair practices of a number of countries. As detailed above, some of our trading partners have failed to implement their Uruguay Round commitments in significant respects. NPPC urges this subcommittee to support any measures that will encourage our trading partners to honor their Uruguay Round obligations and facilitate the dismantling of the foregoing trade barriers.

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